104

SMALL BUSINESSES' ACCESS TO CAPITAL: THE ROLE OF BANKS IN SMALL BUSINESS FINANCING

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

WASHINGTON, DC, MAY 1, 1996

Printed for the use of the Committee on Small Business

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SMALL BUSINESS' ACCESS TO CAPITAL: THE ROLE OF BANKS IN SMALL BUSINESS FINANCING

WEDNESDAY, MAY 1, 1996

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to notice, at 10:05 a.m., in room 2359, Rayburn House Office Building, the Honorable Jan Meyers (Chair of the Committee), presiding.

Chair MEYERS. Good morning. The Committee will come to order.

Our hearing this morning is the second in a series that this Committee is holding on small businesses' access to capital. At the first hearing on February 28, we asked witnesses representing five prominent small business advocacy groups to address the current conditions and availability of capital for small business. We wanted to know what specific obstacles and opportunities small businessmen and women face in this area.

Those of you who attended that hearing will no doubt remember that much of the witness testimony and an even greater amount of the discussion focussed on bank lending to small business. In general, the witnesses pointed to the difficulties of securing small business bank loans and the demise of community bankers, which has led to weakening relationships between bankers and borrowers, as well as a decline in so-called character loans.

The witnesses also noted that the high collateral and paperwork requirements that banks demand from borrowers as well as various other regulatory barriers present significant obstacles for small businesses seeking bank loans.

Our witnesses' statements were underscored by a recent article in the March 14 edition of American Banker Magazine which cites a Federal Reserve paper claiming that between 1989 and 1994 bank lending to small business dropped by 34 percent. The paper also predicts a 32 percent drop over the next 5 years.

According to our witnesses, as a result of the declining role that banks are playing in small business financing, many small businesses are turning to nonbank lenders and credit cards for their capital needs. While these sources of capital are generally more expensive, they are also frequently more accessible.

As has been the case throughout this series of hearings, today we will examine the private market rather than government-sponsored sources of capital. There are indeed differing opinions with respect to how best to increase small businesses' access to capital.

It is my personal opinion that when appropriate, the Government should encourage private sector initiative in this area by removing whatever obstacles and disincentives that exist for banks to lend to small business rather than simply increasing the role of government-sponsored capital sources.

I have asked the witnesses before us today to address the bank lending issues raised by the witnesses at our first hearing. Specifically, I have asked the private sector witnesses to identify the various impediments or disincentives that banks face in lending to small business. I have also asked them to assess how, despite these impediments, certain banks have been successful in making small business loans.

I have asked the regulatory witnesses to assess the overall regulatory climate for small business bank lending. Are conditions now generally better or worse since the so-called credit crunch of the early 1990's? In addition, I have asked them for suggestions to improve small business access to bank loans. Finally, I've asked today's witnesses to give us their opinions on the effects of industry consolidation and competition from other capital sources.

It is my hope that this hearing will give us a more accurate picture of the current state of bank lending to small business and help identify ways to improve small business' access to this important source of capital.

At this time I would like to recognize the Ranking Member of the Committee, the Honorable John LaFalce.

Mr. LAFALCE. Thank you very much, Madam Chairman. I certainly want to thank you for conducting this morning's hearing.

The capital needs of small business and the role of financial institutions in meeting these needs are topics of great concern to me. They're also issues that I've worked on extensively over the years, both in this Committee, especially those years that I was chairman, and in the Committee on Banking and Finance.

Over the past few years I've conducted many hearings to examine various aspects of the credit crunch of the late 1980's and the early 1990's when most were saying there was no credit crunch, but I was concerned the impact that credit crunch was having, especially on small businesses.

Now, I appreciate the opportunity to address the issues but I think the focus of the hearing could be a little clearer. On the one hand, the announced purpose of the hearing is to investigate the issues raised in the February 28 Subcommittee field hearing in Boston on the effects of bank consolidation on small business lending.

Certainly the presence of Governor Yellen of the Federal Reserve Board and Vice Chairman Hove of the FDIC present the Committee with an opportunity to discuss how the changing structure of our banking system may affect small business lending. The Federal Reserve System in particular has produced several interesting studies on bank lending and bank consolidation that are of significant interest to me.

However, a review of some of the witness testimony and the hearing briefing materials that were distributed earlier suggest that rather than investigating key issues and data relating to commercial bank lending to small businesses and the impact of bank

consolidation, which I think we should be doing, the purpose of the hearing will be to focus in large part, once again, on the claims of excessive Government regulation and paperwork, this time in banking and financial services.

The absence of SBA's Office of Advocacy is also something that's of concern to me because in each of the last 2 years, the Office of Advocacy has produced the most extensive analyses of commercial bank lending to small business by both large and small banks. Advocacy also has produced the best analysis of data from the Federal Reserve and other sources on changing patterns of small business lending. Perhaps they can be invited to some future hearing.

It's my hope that we will take the opportunity of this morning's period, however, and hopefully some additional hearings, to examine and better understand how the changing structure of our financial services system and our commercial banking system in particular may be affecting the availability of credit for smaller businesses.

Study after study has shown that commercial banks are by far the single most important source of all forms of credit for small businesses. While SBA figures show a slight increase in total bank lending to small business over the past year, at least one study, a very important study by Federal Reserve economists Allen Berger, Joseph Scalise and University of Chicago economist Anil Kashyap, estimates that bank lending to small businesses has declined by 34 percent since 1989 and is expected to decline an additional 32 percent by the end of the decade.

Assuming the accuracy of this look-back and probable accuracy of this look-forward, those would be very disturbing.

The study that I just referred to attributes this decline in small business lending, at least in part, to the thousands of bank mergers that have taken place since the 1980's. Since out-of-State bank holding companies consistently show lower ratios of small commercial loans to deposits than local independent banks, there's reason to be concerned that further bank consolidation may continue to restrict small business lending. I'll be very anxious to hear the thoughts of the panelists on this.

I believe the changing structure of our financial services industry has far greater influence on the availability of small business credit than any issue or problem of Government regulation and red tape. The Committee on Banking considered regulatory reform issues at length last year. The resulting regulatory relief bill includes some very important improvements but it's now stalled, and for good reason.

Despite complaints from the banking industry that excessive regulation was inhibiting lending to both consumers and small business, many of the legislative changes actually put before the Committee had little to do with reducing legal or technical impediments or disincentives in current regulation or procedure. Rather, a number of the proposals within the regulatory relief bill sought to overturn many legitimate safety and soundness protections enacted in the wake of the thrift crisis, to limit bank disclosure and liability to consumers; most importantly, to cut enforcement of community lending requirements under the Community Reinvestment Act,

something that would be anathema to the small business community.

Despite broad bipartisan support for eliminating truly unnecessary and burdensome financial regulation, the chance for enacting a meaningful financial services regulatory relief bill has been undermined by some of those extremist positions. I think there's consensus on 90 percent of the bill. If we could just take away the extremist positions we should be able to sail the bill right through the House.

In the meantime, I want to give a word of kudos to the regulators. The regulators in the past few years have taken some very meaningful steps to ease compliance and regulatory burdens on financial institutions. Over the past 3 years we've seen far more significant regulatory burden relief for banking institutions than in any comparable period that I'm aware of.

Banking supervisory agencies have eliminated or rewritten dozens of regulations, simplified small bank examinations, revised and simplified bank lending limits and capital calculations, reduced reporting and recordkeeping requirements and greatly simplified CRA compliance. This effort has been substantial and it continues.

Unfortunately, effective regulation necessarily entails some amount of compliance burden. We'll never eliminate that. We need to review the regulatory framework to eliminate, though, any unwarranted burdens. We also need to keep in mind the original motives of promoting bank safety and soundness and protecting taxpayers and consumers.

I look forward to hearing from the witnesses. Thank you.

Chair MEYERS. Thank you, Mr. LaFalce.

We have a distinguished panel with us today and our first witness is the Honorable Andrew C. Hove, Vice-Chairman of the Federal Deposit Insurance Corporation. Mr. Hove.

Mr. POSHARD. Madam Chairman, may I ask unanimous consent to submit an opening statement for the record?

Chair MEYERS. Without objection, so ordered. If there are others, I would ask unanimous consent that all Members be allowed to submit an opening statement. Thank you.

Chair MEYERS. Mr. Hove.

[Mr. Poshard's statement may be found in the appendix.]

TESTIMONY OF THE HONORABLE ANDREW C. HOVE, JR., VICE-CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. HOVE. Thank you, Madam Chair, members of the Committee. I'm pleased to have this opportunity to testify before you today on behalf of the Federal Deposit Insurance Corporation on the issue of credit availability for small business. With your permission, I will summarize my written testimony, which discusses recent trends in small business lending, our analysis of the potential impact on credit availability of increased consolidation of the banking industry, and the on-going efforts to reduce regulatory burden by streamlining regulations and coordinating the supervisory process.

When I last appeared before you in April 1993, the recession of the early 1990's was ending and the FDIC had just begun to see the first signs of increasing strength in the economy and increasing

demand for credit from households and businesses. At that time, the banking industry was attempting to resolve the large number of remaining troubled assets from the 1980's. Bank lending to business had declined in virtually every quarter throughout the 1990 to 1992 period.

By the first quarter of 1993, however, the industry was well positioned to lend. Over 95 percent of the Bank Insured Fund-insured banks were well capitalized. Liquidity levels were high and the FDIC estimated that the industry as a whole could support asset growth of $500 billion and still remain well capitalized.

Since my 1993 testimony, the banking industry has demonstrated continuing strength. Commercial banks have attained record high earnings and have maintained both high liquidity and capital levels. Last year, commercial banks achieved record earnings for the fourth consecutive year.

The improvement in the health of the banking industry over the past 3 years has been accompanied by increased lending to small businesses. Between midyear 1994 and midyear 1995 loans by FDIC-insured commercial banks to small businesses and small farms increased by $23.6 billion or 6.8 percent and smaller banks with less than $300 million in total assets accounted for 42.4 percent of that total volume of loans.

Given the important role that small banks play in extending credit to small businesses and small farms, some observers have expressed concern regarding the availability of credit to this sector if industry consolidation trends continue. Banks with less than $100 million in assets, however, remain the most numerous category of institution. As of December 31, 1995, there were 6,659 commercial banks in this category, which held 22 percent of all the loans to small businesses, even though they represented only 6.8 percent of the industry assets. They operate in over 4,000 cities and towns in which there are no offices of larger banks, providing essential financial services to consumers and businesses.

In 3 of the last 6 years, banks with assets of less than $100 million were more profitable than the industry average, as measured by return on assets.

Small institutions have demonstrated the ability to thrive in both large and small markets. While smaller banks may not have the financial resources to service major corporate customers to the same extent as larger banking institutions, smaller banks have certain advantages in working with smaller, local businesses. Their necessary focus on the local community has enabled small banks to specialize in extending credit to small businesses and small farms.

Although the trend toward consolidation in banking appears likely to continue, the data suggest that the smaller banking organization focused on service to a particular local community and taking advantage of competitive strengths resulting from that focus can continue to prosper.

In addition to consolidation, regulatory burden can affect the ability of banks, and especially smaller banks, to lend to small businesses. In recent years, the regulatory agencies have taken numerous steps to simplify and clarify supervisory policy and reporting requirements in an attempt to remove impediments to bank

lending that might occur due to necessary costs or supervisory burdens.

When I testified before the Committee in 1993, the FDIC had joined with other bank and thrift regulators in announcing a joint program to address the problems of credit availability, especially for small- and medium-sized businesses and farms.

The program addressed five areas: Number one, lending to small and medium-sized businesses and farms; number two, real estate lending and appraisals; number three, paperwork and regulatory burden; number four, appeals of examination decisions and complaint handling; and number five, examination processes and procedures. Since 1993, the FDIC has addressed each of these areas, which I describe more fully in my written testimony.

The reduction of regulatory burden imposed by unnecessary and cumbersome regulatory requirements is critical to the ability of smaller banks to compete effectively with larger banks and nondepository financial companies. Regulatory relief is a major initiative at FDIC.

In 1992, I directed a review of each FDIC regulation, policy statement and program in order to identify and accelerate action on initiatives that would eliminate any unnecessary burden or otherwise promote economic growth. In addition, to implement the Riegle Community Development and Regulatory Improvement Act of 1994, the FDIC is currently reviewing 120 regulations and policy statements. We're evaluating each of them to determine whether they are necessary to ensure a safe and sound banking system, whether they enhance the functioning of the marketplace and whether they can be justified on strong public policy grounds related to consumer protection.

In conclusion, I believe that the initiatives we have implemented, taken as a whole, have created a climate that is more conducive to lending and eliminated some misunderstandings that existed in the industry. The relationship between increasing credit availability and reducing regulatory burden, however, is an indirect one that's not easy to measure.

Although it's almost impossible to isolate and allocate the improvement in the lending climate between reduced regulatory burden and a generally improved economy, both factors have contributed to improving opportunities for small business lending.

I'll be happy to answer your questions. Thank you very much.

Chair MEYERS. Thank you very much for your testimony, Mr. Hove.

[Mr. Hove's statement may be found in the appendix.]

Our next witness is the Honorable Janet Yellen and she's a Governor of the Federal Reserve System. Thank you for being with us, Dr. Yellen.

TESTIMONY OF THE HONORABLE JANET L. YELLEN, GOVERNOR, FEDERAL RESERVE SYSTEM

Dr. YELLEN. Thank you, Madam Chair. I'm pleased to be here today to discuss the environment for small business financing and the role of banks in providing credit to small firms. My oral comments will be brief and I'd ask that my longer statement be included in the record.

I think we would all agree that the financial environment today is markedly improved from that of early 1993, when Chairman Greenspan appeared before this Committee to discuss small business credit. While undoubtedly there remain pockets of weakness, a wide array of statistical indicators suggest that access to bank credit has eased appreciably for all businesses since that period.

Business loans at banks expanded rapidly in the last 2 years. Small businesses participated in this expansion. Data collected from banks in the June Call Reports revealed that small commercial loans increased more than 7 percent between June 1994 and June 1995. Roughly a third of the growth in small loans over that period occurred at 7,000 mostly small and regional banks whose business loan portfolios comprise only small loans. A good portion of the expansion, though, was at large banks with more than $5 billion in assets.

While the growth in loans has been importantly demand-related as the economy expanded, the willingness of banks to supply credit also has been on the upswing. Continued improvements in bank profits, healthy capital positions and low delinquency rates on business loans have encouraged banks to compete aggressively for business customers.

Perhaps the most telling evidence of improved financing opportunities are reports from small businesses themselves. Small- and mid-sized firms surveyed by the National Federation of Independent Businesses had reported that interest rates and financing were among their most pressing problems in the early 1990's. Only a small percentage of firms cited this as a concern in recent surveys. The Federal Reserve's National Survey of Small Business Finances, which is highlighted in my written statement, quantifies the important role that banks continue to play in small business financing.

Looking ahead, there are a number of developments in banking markets that may be significant for small businesses. Perhaps the most prominent is the on-going consolidation of the banking industry, which some fear will have a negative impact on small business lending. We are likely to see merger activity continue for a while and inevitably some banking relationships will be disturbed when ownership and management change. However, we would expect these effects to be short-lived.

Analyses of banking markets over the years have provided little support for the notion that when large banks enter a market they drive out the smaller banks. Our staff studies have shown that smaller banks typically perform as well or better than their larger counterparts, even in markets dominated by large institutions.

Should large banks find it too costly to establish a lending presence in small business markets, perhaps because it's inefficient for large, remote institutions to maintain close working relationships with small customers, then other small banks in the area and new entrants will be positioned to fill the gap. Indeed, there were many reports that community banks were eagerly looking to increase their market shares following some of the large bank mergers last year.

I offer these generalizations with caution. The Federal Reserve takes very seriously its responsibility for evaluating the possible impact of bank mergers on local markets. We've found that each

assessment must be done on a case-by-case and market-by-market basis. To this end we devote considerable resources to assessing competitive impacts, CRA concerns, and a variety of other factors, and we will be watching closely for evidence that small businesses are being disadvantaged by bank mergers.

A number of other changes in the credit markets seemingly bode well for small business financing, including the efforts of large institutions to meet community development concerns and enhance their presence in local markets.

In addition, new technologies and information flows are providing opportunities for banks and other lenders to more efficiently evaluate loan risks. Many large banks already have begun to probe the possibilities of credit scoring techniques for small business markets. We anticipate that the cost savings generated through these new processes will, if not passed on to small business customers, at least permit banks of all sizes to continue profitably serving this sector of the credit markets.

I'm optimistic about the outlook for small business credit availability. We have emerged from the credit crunch into a much sounder financing environment and a well balanced economic expansion. Moreover, many of the new developments in banking point to more efficient risk management techniques that could lower the cost of small business lending. At the same time, many of our large banks have become quite actively involved in small business and community development programs.

Our conversations with bankers and small business groups suggest that bank regulatory issues are not the pressing concern today that they were a few years ago. Nonetheless, we, as regulators, will continue to review our rules and procedures to ensure that unnecessary burdens do not hinder banks' willingness to lend to creditworthy small businesses. Thank you.

[Dr. Yellen's statement may be found in the appendix.]

Chair MEYERS. Thank you, Dr. Yellen.

Our next witness is Ms. Sandy Maltby. She's senior Vice President for Small Business Services of KeyCorp in Cleveland, Ohio. She's also a member of the Small Business Council of the U.S. Chamber of Commerce, and we're glad to have you with us.

TESTIMONY OF SANDY MALTBY, SENIOR VICE PRESIDENT, SMALL BUSINESS SERVICES, KEYCORP, CLEVELAND, OHIO

Ms. MALTBY. Thank you. Madam Chair, on behalf of KeyCorp and the Small Business Council of the U.S. Chamber of Commerce, I would like to thank the Chair and the Committee for giving us the opportunity to talk about the new role that we believe banks are having with the relationship with small business customers.

For your information, KeyCorp is headquartered in Cleveland, Ohio. We're the Nation's second largest lender to small businesses. We're also one of the Nation's largest bank holding companies, with $66 billion in assets. We're a national banking company with more than 1,300 offices in 13 States, ranging from Maine to Alaska. We've gotten to be our size at $66 billion through over 100 mergers over the last 20 years.

At Key we have many different types of small business customers, ranging from lobster fishermen in Maine, florists in Utah,

apple growers in Washington and office supply companies in Anchorage, Alaska.

Throughout our experience in working with small business owners, we've learned five principles of dealing with small business customers. First, of course, is that these enterprises do need unimpeded access to capital.

Second, though, is that success depends on more than just capital. Entrepreneurs need a full range of banking services but they also need help in personnel management, understanding regulatory requirements, sales management and even referrals to accountants and lawyers.

Third, it is decidedly in our best interest as a bank and a lender that our customers be informed and astute managers in the best way to optimize and make the most out of their business.

Fourth, entrepreneurs are different. They're not like you and I. We all need to learn how to do business on terms that are acceptable to entrepreneurs and small businesses.

Fifth, they need to work with bankers who are local, bankers who are knowledgeable about them, about their business, and knowledgeable about issues that are common to growing businesses.

Out of these five principles and years of working with small businesses has evolved our KeyCorp model for small business banking. It's an approach that attempts to address the twin issues of access to capital but also access to knowledge and skill.

We have organized our small business banking model to deliver capital, skills and banking services and we've been successful in serving small businesses by offering five key strategies.

First, we do offer customized financial solutions for small businesses. They're pretty much the same services that you'll see at many banks but at KeyCorp we haven't taken the same products that we offer Fortune 500 customers and just provided them to small businesses. Instead, entrepreneurs have access to the same benefits of the products and services that a Fortune 500 company can get but they're provided to an entrepreneur in a way that's easy for them to understand.

Second, KeyBank offers many local resources. Just a few weeks ago in Columbus, Ohio we opened an office that is specifically dedicated to serving small business customers. In this office in Columbus, Ohio we have specially trained bankers that we've trained on how to talk and consult with small business customers. We have a mix of personal computer-based resources to help entrepreneurs adopt strong management practices, understand what sources of capital are available to them. The KeyCenter is like no other branch that you've seen in a typical bank for small businesses.

Third, is our mentor program and networking opportunities. Our customers tell us that it's lonely at the top being a small business owner and they don't know where to go to for information and help. At KeyBank of Maine, for example, KeyBank employees that might have an expertise in finance or marketing will sit and work with entrepreneurs to help them solve business challenges and help them navigate their way to success.

Fourth, is our advocacy component. KeyCorp can help small businesses get their voices heard in support or in opposition to Govern-

ment proposals or regulations. As a large bank, we have the opportunity and the stature to help small businesses all around America get their voices heard.

For example, last year KeyCorp hosted over 100 small business owners to Washington, DC to meet with U.S. Senators, Congressmen, and SBA officials. Following that forum, we had meetings in 13 States with our local legislators to help address small business issues.

Last and most important is our people. At KeyCorp we have a one-of-a-kind, comprehensive certification program that our employees will go through and learn how to consult with small businesses to make their businesses more successful. We learn how to talk the talk of entrepreneurs.

So you might be asking yourself, what does this have to do with access to capital? Well, that's precisely our point. At Key we believe that if we're a resource to our small business customers and we can provide them with tools they need to run a successful business, we're then in a better position to lend to them when they need their access to capital and they're in a better position to borrow.

Serving small businesses is not a sometime thing at KeyBank, so we're willing to invest in long-term relationships with small business customers. I think our success has proven that as a large bank, $66 billion in assets, if you don't take your eye off the customer and invest in a long-term relationship with entrepreneurs, you can grow as a banking institution while still meeting the needs of your local community.

I've been in this business for 18 years and I've seen a lot of very positive changes as a result of banking mergers. Through the decades of rising competition and consolidation, we've always known that our secret weapon in banking was our location. We're rooted in our communities and we're a key component of our neighborhoods. That closeness is what we believe at KeyBank gives us the knowledge to help build America's small businesses. The historical forces that are occurring in banking have given us the incentive to change. Thank you.

[Ms. Maltby's statement may be found in the appendix.]

Chair MEYERS. Thank you very much, Ms. Maltby.

Our next witness is Dr. Cynthia A. Glassman, managing director of Furash & Company, Washington, DC.

TESTIMONY OF CYNTHIA A. GLASSMAN, PH.D., MANAGING DIRECTOR, FURASH & COMPANY, WASHINGTON, DC

Dr. GLASSMAN. Madam Chairman and members of the Committee, I appreciate the opportunity to give my views on the environment for small business lending. It is an area on which I have spent much of my career at the Treasury Department, at the Federal Reserve Board, and in my current position as a managing director at Furash & Company, where I consult with financial institutions on small business issues.

I will summarize my written testimony, which covers three topics: The current environment compared to the so-called credit crunch, regulatory impediments, and the role of nonbank lenders.

The current environment is excellent. Banks are healthy, their capital positions are strong, and earnings have hit record highs for

the last 4 years. Technological advances have reduced the cost of small business lending and regulators are encouraging banks to lend to small businesses.

With a growing economy, banks are willing and able to lend to small businesses. Competition is intense. According to NFIB surveys, credit availability is not a significant issue for its members.

This contrasts markedly with the so-called credit crunch of the early 1990's. Then, the banking industry was not healthy. Over 1,000 banks failed between 1982 and 1992. Severe credit quality problems meant earnings had to be used to buildup loan loss reserves.

At the same time, as FDICIA was being debated and ultimately passed, banks had to improve their capital-to-assets ratios. There are only two ways to accomplish this: Increase capital or decrease assets.

Increasing capital by retaining earnings or issuing new equity was not easy at the time, so many banks had to shrink assets by limiting lending. Overlay that with bank and regulator concerns about borrowers' credit quality and it should have been no surprise that bank lending in general and to small businesses in particular was not going to be strong.

But despite the better environment now, there are still concerns that small businesses face obstacles in obtaining bank credit. Before addressing them, though, I would like to make two key points.

First, not all small businesses are credit-qualified, no matter how good the lending environment is. Second, a bank's primary business is to lend money and to get paid back.

At your earlier hearing the issues raised included the impact of consolidation, the demise of character loans, and current regulatory impediments. There is no question that consolidation has picked up steam and will continue for the next few years, but, in my view, there will still be thousands of banks by the end of the century.

There are several reasons for the consolidation and they include elimination of restrictions, economies of scale and scope, technology and efficiencies.

One concern about consolidation is that it replaces community banks with large organizations that do not serve small businesses well. But for many large retail banks, small business banking is a key strategic initiative. They have created units that focus on small business; dedicated staff; established financial incentives; streamlined their credit process, and introduced products tailored to meet small business needs. In fact, banks with assets over $1 billion make the majority of commercial bank loans to small business.

Turning to character loans, they are less prevalent than they used to be, and for a good reason. No matter how much a business owner wants to repay a loan, if the business does not generate earnings and cash flow or have the collateral to support the loan, the business owner cannot repay, despite his or her good intentions.

That brings me to regulatory impediments. The apparent belief is that if regulators evaluate each individual loan then banks will be less willing to take on risky loans. In our experience the regulators are moving away from loan by loan reviews and looking at small business loan risk on a portfolio basis.

Finally, nonbank competition for small business loans is increasing. Banks are clearly important, but nonbanks have made substantial inroads. According to the Fed study, 37 percent of small businesses had a credit line, loan or capital lease at a bank, but 19 percent had such a borrowing relationship with a nondepository institution, namely at a finance company or a leasing company.

The Money Store, a finance company, is the largest SBA lender and has been for years. Merrill Lynch's small business loans outstanding reportedly have grown to close to $1 billion. According to a Consumer Bankers Association recent survey, 58 percent of respondents consider Merrill Lynch to be their third largest competitor, after regional and community banks.

In sum, both bank and nonbank competition for small business loans is strong and growing. To reiterate, the small business lending environment is quite hospitable these days. The market is working. Thank you.

[Dr. Glassman's statement may be found in the appendix.]

Chair MEYERS. Thank you very much, Dr. Glassman. We appreciate your being here.

Our next witness, without prejudice, of course, is from what we like to call real America, God's country, USA. He's Frank A. Suellentrop and he's President of the State Bank of Colwich, Kansas and he is here today speaking for himself, of course, but also representing the Independent Bankers Association of America. Mr. Suellentrop.

TESTIMONY OF FRANK A. SUELLENTROP, PRESIDENT, STATE BANK OF COLWICH, COLWICH, KANSAS, REPRESENTING THE INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. SUELLENTROP. Thank you, Madam Chair and members of the Committee. I am Frank Suellentrop, Chairman of the Community Bankers Association of Kansas and President of the State Bank of Colwich, Kansas. We're a small community bank with approximately 34 employees.

The Independent Bankers Association of America, IBAA, appreciates this opportunity to present our views on the subject of the role of banks in small business financing. IBAA represents the interests of about 5,500 independent community banks nationwide. Our Community Bankers Association in Kansas similarly represents approximately 430 banks in Kansas and 150 in our organization, including 14 in the Third Congressional District. We have talked with several of these Third District banks, whose views are incorporated into this statement.

In the interest of time, Madam Chair, I would like to summarize my remarks and submit my full statement for the hearing record.

At the outset, our associations wish to commend and thank the chair for her outstanding work on behalf of small business. Not only is Miss Meyers the first woman chair of a Congressional Small Business Committee, but arguably she is the most energetic. In addition to her monthly Small Business Association breakfast, there were 59 public Committee and Subcommittee hearings during 1995, more than one per week.

This Committee developed and guided to enactment legislation preserving and enhancing SBA loan programs that are so important to small businesses nationwide.

We also appreciate the chair's support of family tax relief for farms and small businesses, which IBAA believes is critical to preserving small communities in a diversified, decentralized economy.

So thank you for this record of achievement. I hope that portion won't be taken out of my time.

Chair MEYERS. We'll try to work it in.

Mr. SUELLENTROP. As noted in this Committee's February 28 introductory hearing, almost all small businesses are unique. Based upon tax returns filed, there are 22 million individual businesses in the United States. The National Small Business United witness on February 28 surveyed the diversity of small businesses and observed that there's no single silver bullet that will solve the financing problems of all segments of small business. IBAA agrees and we believe that these conditions call for financial service providers, legislators and regulators to work together toward improving multiple avenues of access to capital for the range of small businesses.

Public and private studies show that small businesses had accounted for two-thirds of the net new jobs since the early 1970's. Job creation in the U.S. economy has been a remarkable success story. Community banks, according to the Federal Reserve, are the most important source of both financing and advice for small business. Our banks are thus partners of small business in our Nation's economic growth and job creation.

This partnership has been good for small business and for the U.S. economy. The core of business of community banks is servicing the financial needs of the communities, including small business, farms and consumers. Community banks are locally owned and operated. Their boards of directors are composed of local citizens who have a natural interest in building up the towns and cities where they live and where their banks do business.

The State Bank of Colwich is a rather typical community bank. We have about $65 million in assets. As of March 31 we had 288 business loans outstanding with about 20 conventional small business loans for every SBA loan. In making small business loans, community bankers are more willing to assess the borrower's character and his or her family history.

Branch managers of chain banks often do not have this kind of local experience. If the risk of a character loan is greater, the community banker may charge a little more for the loan, but community banks will frequently take a chance on a business venture of a reliable local citizen in hopes of creating a long-term relationship with a successful business.

NFIB's February 28 testimony confirms that availability of credit is the most important factor to any small business. The price of the credit is secondary.

My experience is that fees and documentation, which the small business owner perceives as extra cost and paperwork, can be a real detriment to using the SBA program and should be minimized.

Federal Government statistics make the point that small community banks holding about 15 percent of deposits loan about half of

all the dollar amounts of less than $250,000, the heart of small business lending.

Responding in large part to the public policy decision by the last Congress to permit full nationwide banking and interstate branching by 1997, the banking industry in the last 15 months has experienced massive consolidation, branch closings and job losses. Unfortunately, Madam Chair, legislation is pending before the House Banking Committee which would open the door to common ownership of the largest commercial banks, securities firms and insurance underwriters.

Thus, financial concentration is a major concern to the small business community and American agriculture. It is with regret that we oppose the financial consolidation package that Chairman Leach is putting together, a package that will benefit Wall Street to the detriment of Main Street.

As this historic Congress comes into its home stretch, it could take one action that would go a long way toward preserving the environment for community banks. We urge this Congress to keep the promise and accord community banking relief from a crushing regulatory burden. A mean regulatory burden relief bill is pending before the House leadership but unfortunately is being kept hostage to a broader financial restructuring bill, which does not accord with the interests of the Nation's small business community.

Regulatory relief is the number one priority of community banks this year. The accounting firm of Grant Thornton surveyed 2,600 community banks and found that the cost of compliance with a dozen most pervasive Federal regulations was $3.2 billion per year, with one third of this total, over $1 billion, attributable to the Community Reinvestment Act.

These regulatory burdens are breaking the backs of independent banks and making it more difficult for them to meet the credit needs of their communities, and also one of the main reasons that they're looking at consolidations.

Our small business customers also suffer from overregulation and similarly need relief. Another action that would be helpful is the passage of legislation introduced by Congressman Baker to reform the Federal Home Loan Bank. Community banks in rural America are beginning to encounter liquidity problems as core deposits flow to mutual funds. As we well know, mutual funds do not make small business loans.

Chairman Baker's proposed reform of the Federal Home Loan Bank system would make advances from Federal Home Loan banks more readily available to small businesses and agriculture.

We're also pushing to allow community banks to tap the funding source of the farm credit system, which enjoys GSE status.

Longer term, we strongly urge Congress to review the privileged status of credit unions. Larger credit unions are virtually indistinguishable from commercial banks but are exempt from Federal and State taxation and also exempt from other banking standards, including the Community Reinvestment Act.

Nonbank lenders are not subject to bank-like supervision. They can sell both guaranteed and unguaranteed portions of SBA-guaranteed loans into the secondary markets, which commercial banks cannot.

Government programs of guaranteeing credit are important to small business, independent banks and their communities. They make possible loans that would otherwise be unbankable. Securitization is coming to the business loan marketplace and experts have already expressed concerns that the securitization process will reduce the role of community banks in financing small firms. We share these concerns.

Community bankers fought hard during Congress for a tax program that is largely small business-oriented. We were gratified when a number of these provisions passed Congress as part of the Balanced Budget Act. Community bankers also feel strongly that the tax subsidy of larger, bank-like credit unions should be repealed.

In conclusion, Madam Chair, community banks, with their specialized financing skills, will be needed to provide the combination of credit and advice to give new small businesses, including increasing numbers of women-owned and minority businesses, their best chance for success. We thus favor revisiting this type of inquiry periodically. Meanwhile, research on these matters should continue on Capitol Hill and the executive agencies to provide a basis for public policy decisions on U.S. financial structure and its ability to provide capital to the vital small business sector of our economy.

Thank you for the opportunity.

[Mr. Suellentrop's statement may be found in the appendix.]

Chair MEYERS. Thank you very much for being with us, Frank. We're glad to have you here.

Our next witness is Mr. James Dowe and he is President of Bangor Savings Bank in Bangor, Maine and he is speaking for himself, of course, and is representing America's Community Bankers. Mr. LaFalce has asked to say a word prior to your testimony.

Mr. LAFALCE. Thank you very much, Madam Chair.

Mr. Dowe, Congressman John Baldacci, an outstanding member of this Committee, did want to introduce you before your testimony and tell the world what a great job you're doing as President of Bangor. Unfortunately he had a previous commitment that he had to keep and couldn't make it, but Madam Chair, I'd like to introduce into the record the flowery, laudatory words of Congressman Baldacci concerning Mr. Dowe, with your permission.

Chair MEYERS. Well, after carrying on about Mr. Suellentrop I feel like I have to give you that opportunity, so without objection, so ordered.

Mr. LAFALCE. I've some brief meetings with all the previous witnesses, too. I was especially pleased to see Miss Sandy Maltby of KeyCorporation. Although they're not headquartered in my congressional district, they should be. Pass that on to Bob or Victor or whoever made that decision.

One more thing while I have the microphone for a brief minute. I'm very, very pleased to welcome a new member of the Small Business Committee. He attended one previous meeting and got here after I'd left so I didn't have an opportunity to introduce him to the Committee at that time.

But I think the Committee is going to be magnificently served and I think the Congress and the country are going the be magnifi-

cently served by one of our newest Members, Congressman Jesse Jackson from the great State of Illinois. Congressman Jackson first came to my attention at a Democratic convention when his eloquence surpassed his father.

You don't have to worry. Whenever you say that a son does something better than his father, that always pleases the father. I can't say he surpassed Mario Cuomo or anybody else but I can say he surpassed his father in his oratorical excellence and I know that he will be an outstanding member of this Committee, the Banking Committee, and of the Congress. We're delighted to have you here.

Mr. JACKSON. Thank you very much.

Chair MEYERS. We are very pleased to have Mr. Jackson as a member of this Committee and welcome him.

Mr. JACKSON. Thank you, Madam Chair.

Chair MEYERS. Mr. Dowe.

TESTIMONY OF JAMES DOWE, PRESIDENT, BANGOR SAVINGS BANK, BANGOR, MAINE, REPRESENTING AMERICA'S COMMUNITY BANKERS

Mr. DOWE. Thank you. Chair Meyers and members of the Committee, my name is Jim Dowe. I'm President of Bangor Savings Bank, a mutual institution in Bangor, Maine. Bangor Savings has $715 million in assets and is an active lender to the small business community.

I am pleased to appear before the Committee on behalf of America's Community Bankers, where I serve on the board of directors. ACB is a national trade association of 2,000 community savings and financial institutions and related business firms. The industry has more than $1 trillion in assets, 253,000 employees and 14,500 offices.

I would like to state at the outset that community banking is alive and well. Small business customers prefer to do business with their local community bank where they know the people and have ready access when the need arises.

An added value, secret weapon, for Bangor Savings Bank and many community bankers is intimate knowledge of our local business customers and their needs. Our loans are to family business people we believe in and trust.

Before discussing our specific recommendations, I would like to review briefly a few examples of small business lending by Bangor Savings. Generally these are small family business loans that large out-of-State banks, going by the book, might not make.

For example, we recently granted a very small loan to two women who wanted to start a hairdressing salon. Their salon had been part of a national chain but the women wanted to start their own store. That business is now doing quite well. Several factors went into the decision to grant these women the loan. They had been in business for a number of years and, as a result, knew what they were doing. Most of all, they provided us with a cost breakdown—1½ pages, single-spaced, that included $3.95 for a dustpan and $14.95 for a push broom. That kind of commitment showed energy, thoroughness and thoughtfulness—pure character.

In a small rural town north of Bangor we financed a local mother of two to acquire a day care center. She'd worked at the center but then the current owners had lost interest in the business. The determining factor in granting the loan was the woman's knowledge of that line of business. Most of all, however, we believed in her and knew instinctively that it was the right thing to do for her, the children and the bank.

In another rural Maine town a small company made wooden toys. A craftsman working for the company came to us wanting to buy the company. The craftsman had no prior business experience but we made him a modest loan, which included an operating line of credit. Since he bought the company his business has boomed to the point that the new owner has been featured on television and in several magazines.

We made the loan to him because he had the fundamental skills needed. He understood the problems of the business and how to solve them.

What can Congress do? A strong savings institution industry operating under a rational and supportive legal and regulatory regime is critical to providing continued support for community small business needs. ACB believes that Congress can and should act on several fronts to promote a more favorable competitive environment for depository institutions to serve the small business community. The following are ACB's nine priorities for Congressional action.

First, I want to mention briefly an issue that will profoundly affect the ability of many savings institutions to continue to serve the small business community. It is unfortunate that Congress did not include in the 1996 omnibus appropriations package language to solve the huge disparity in the deposit premiums paid by Bank Insurance Fund members and those paid by Savings Association Insurance Fund members. This is a problem that needs to be fixed at the earliest possible date.

From my standpoint as a BIF-insured bank, I think the GAO, CBO, FDIC, Treasury, OTS, Federal Reserve and others did an excellent job in focussing attention on the BIF/SAIF disparity and the dangers that it presents to the financial system. The public does not differentiate between the two insurance funds administered by the FDIC, and neither should the policymakers.

Second, Congress should reduce the regulatory burden on depository institutions, consistent with safety and soundness. ACB strongly supports the Leach-Bereuter bill in the House and the Shelby-Mack bill in the Senate. Both bills are designed to remove unnecessary red tape and duplicative paperwork that in recent years have been strangling lenders.

Third, one means of expanding lending opportunities for small business would be to relax the commercial lending limit for Federal Savings Associations. Under current law, Federal Savings Associations may not invest more than 10 percent of their assets in commercial loans. ACB strongly supports the provision in the Senate regulatory burden relief bill, S. 650, that would increase the 10 percent cap on assets invested in commercial loans to 20 percent, provided that the excess 10 percent be invested in small business loans.

Fourth, Congress must act to restore the intent of the Superfund law and the Solid Waste Disposal Act by clarifying that lenders, trustees, fiduciaries, Government Agencies and others who make secured loans or act as fiduciaries are not liable. Clarification of the Superfund exemption for secured parties will enhance the flow of credit and reduce the cost of credit to small businesses and assist them in undertaking private clean-ups of hazardous waste problems.

Fifth, the scope and frequency of both safety and soundness and compliance examination can impose excessive direct and indirect costs on institutions. Banks need a pattern of consistent examiner standards if banks are to maximize their ability to make available loans to small businesses.

Sixth, by Federal statute, businesses may not earn interest on demand accounts. This unnecessarily restricts the ability of businesses, both small and large, to manage their monies to their best advantage and prevent depository institutions from providing the most efficient and profitable cash management services to their business clients. Permitting the payment of interest on business demand accounts would provide small businesses with a needed tool to assist them in one of the most fundamental of their concerns—management of their cash flows.

Seventh, loan to value. Loan to value limits are lending standards for all insured depository institutions. The specific LTV limits are restrictive, however, for small businesses and startup businesses. We suggest that the Federal banking regulators consider, in their efforts to reduce the regulatory burden, allowing well capitalized or otherwise well performing institutions, when lending to small businesses, to use greater flexibility in judging the creditworthiness of a borrower, market conditions, and other credit quality factors.

Eighth, most small business owners could use expertise on their boards of directors or advisory groups to enhance oversight and corporate decisionmaking. Directors liability insurance is costly and may be out of reach to many small businesses. Were it not for the fear of personal liability in this litigious environment we're in, more people would be willing to take an active role in the small business community.

Ninth and finally, as a society, we generally do a poor job of educating our next generation of small business owners as to the required skill sets they will need to succeed in business. Universities and colleges are striving to address the short-falls in this area but much more needs to be done. While it is important that our current graduates understand how to take a company public in the various capital markets, more time is needed in the basics of small business, such as meeting a payroll and dealing with vendors.

In conclusion, Chair Meyers and members of the Committee, everyone wants to spur small business lending. ABC members want to be in the business of devoting their full energies to investing in their communities and lending to small businesses, not to be in paperwork purgatory.

America's Community Bankers stand ready to assist in any way possible to address these issues. I would be happy to answer any

questions you may have. On behalf of the small businesses of Maine, thank you very much.

[Mr. Dowe's statement may be found in the appendix.]

Chair MEYERS. Thank you very much, Mr. Dowe.

We appreciate the testimony from all of you and at this point I'm going to yield to Mr. Manzullo. I'll go last in questioning and Mr. Manzullo will take my place.

Mr. MANZULLO. Thank you, Madam Chair. I have one question to ask but with the permission of the chair I'd like to ask this question and then yield the balance of my time to Ms. Kelly. Would that be all right?

Chair MEYERS. Yes.

Mr. MANZULLO. We both have to leave.

Chair MEYERS. That's fine.

Mr. MANZULLO. Here's my question and then, Ms. Kelly, I'll give the microphone to you.

We had a hearing on February 28 before this panel and there's a couple of things I'd like to bring up. Number one, NFIB does a great job. I've belonged to it for years. But it only polls people who own existing businesses. They do not poll people who wanted to go into business, never got the capital, and therefore could not participate in the survey.

So I think we have to take a look at that when talking about surveys of capital. The capital needs for NFIB members are probably based more upon expansion requirements and operating expenses, as opposed to initial startup capital.

Murray Gerber from Prototype and Plastic Mold Company representing the National Association of Manufacturers, testified on February 28, and he said, "My conversations with small businesses throughout the State lead me to several conclusions, that there is a lack of capital." He went to say that, "bank staffs no longer have the ability or the need to make smart business lending decisions. Despite the fact that banks widely advertise that they have money to lend to small businesses, the standards are so strict and the amount so low that even those who qualify cannot borrow as much as they want or need. Banks now require collateral twice the size of the loan or demand three sources of cash to pay off the loan. Start-ups have virtually nowhere in the banking system to go."

I'd like you to comment on that. Then I'll yield the balance of my time to Ms. Kelly. Maybe you have a quick question and they can answer my question and yours at the same time.

Ms. KELLY. Our questions are really very co-related in that we are both concerned that beginning industries—those are the things that generate the economy of the Nation—have access to some kind of loans. I did not hear in what you were talking about this morning clearly the sound of anybody stepping up to the plate to try to put in place something that is available for beginning industries, a few people, one or two people, starting.

I know that this is putting you at—these are the high-risk loans. But I also think that there's a couple of things here that were brought up by Mr. Suellentrop and Mr. Dowe. The use of the Federal Home Loan Bank, do you see that as a possibility in this kind of a context? Also, do you see that as a possibility for a regional approach, because there are very big regional differences in the

way the banks are loaning and using funds to capitalize small businesses. Thank you.

Chair MEYERS. Who would you like to comment on this?

Mr. MANZULLO. Whoever wants to answer because this person from the National Association of Manufacturers is saying that there's not a readily available pool of capital.

Chair MEYERS. Does anybody want to start out? Ms. Glassman?

Ms. GLASSMAN. I'd be happy to. My general reaction to that is it's true new businesses need capital but it's not bank lending; they need equity capital, which typically comes through the venture capital arena. Banks essentially can't offer that; they're restricted. So it's very difficult for a bank to meet that need.

One of the other issues you brought up was the collateral and that banks are requiring collateral twice as much as the loan. One thing that's important to point out is what happens when the bank actually has to go to that collateral? The business owner looks at the collateral on an on-going business basis, so they look at it as its current value. But the bank has to look at it on a failed business basis because that's the only time they're going to get it. Then it's on a fire sale basis. So the values are different from the different perspectives.

Ms. KELLY. The Federal Home Loan Bank—I also sit on the Banking Committee—the Federal Home Loan Bank bill that Mr. Dowe referred to would allow the banks to use an equity, a small business equity interest in being able to secure the loans, and I think that is something that I'd really be interested in your comment.

Mr. DOWE. Would you like me to comment on that? I guess I would preface it by saying that we're really looking, I think all of us who sit here representing banks, for ways to make loans. That's our primary source of revenue.

If the Federal Home Loan Bank can provide us with opportunities to safety make loans to——

Chair MEYERS. Could you get a little closer to your microphone? We can hear you fine up here but sometimes it's hard in the back of the room.

Mr. DOWE. Yes. We're looking for ways to make loans to existing small businesses and startup small businesses. It is more difficult; it's a more challenging activity to try to find a way to finance a startup business. If the Federal Home Loan Bank can provide us with some comfort in terms of helping us secure an equity position in the small business, we are very much in favor of that opportunity.

In addition, in the State of Maine, we have an agency called the Finance Authority of Maine, and they have recently—the legislature has recently, I believe, approved a venture capital piece for them, as well. So we expect that in Maine there will be startup capital available through FAME for startup and growing businesses.

Chair MEYERS. Would anyone else like to comment?

[No response.]

Chair MEYERS. Thank you very much.

Mr. LaFalce.

Mr. LaFalce. A good many members of the Small Business Committee also wear another hat, as members of the Banking Committee—myself, Mr. Jackson, Mr. Bentsen, Mrs. Meyers, et cetera, a great many more. So this is an area that we are interested in intimately and somewhat conversant about, too.

I will not get into the BIF/SAIF bill, although it is imperative that we pass that and the commercial banking community might as well come on board. It's going to happen. We've made concession after concession. Let's stop the fight, especially if you're from Texas. We're going to have to deal with the Superfund legislation, et cetera, et cetera.

But right now, let's just focus in on the one issue, and that's the issue of bank lending to small businesses. I'm not too concerned now about doing what you can't do by law and whether that should be changed. I'm worried about the trends that are taking place because of existing law and perhaps other factors.

Let's discuss this economist report from the Federal Reserve, of Berger, who estimates that commercial bank lending to small business, at least in terms of loans of less than $100,000, declined by 34 percent between 1989 and 1994 as a result of banking consolidation. His study predicts a 32 percent decline in small business lending over the next 5 years as the number of independent local banks continues to decline.

Now, as one of the if not the strongest proponent of repeal of McFadden-Douglas, I'm especially concerned at this data. Is the data incomplete? What interpretation should we draw from this data and other data for above $100,000, et cetera? Who wants to—this, to me, is what the hearing should be about. Dr. Yellen.

Dr. Yellen. It's our study. I'd be happy to take it on.

Mr. LaFalce. Did we meet in 1983 when I came out to Brie? You're from Brie, aren't you?

Dr. Yellen. I have participated in some events organized by Brie, yes.

Mr. LaFalce. I came out to Brie in 1983 and I asked Laura D'Andrea Tyson to put together a hearing at that time, when I first met her, and I know that you had an association with Laura, which perhaps had some role in bringing you to the Fed.

Dr. Yellen. Perhaps a very modest role.

Let me try, if I might, to place the Berger study in some perspective. As you mentioned, the Berger, et. al. study does two things. It tries to make a guess as to whether there was decline since 1989 in lending to small businesses as a result of bank consolidation. The second thing it tries to do is to take a look forward and to make some projections about what consolidation——

Mr. LaFalce. You're confusing me now a bit because you used the word guess. What are we guessing about? The decline, or guessing about the causal connection between consolidation and the decline? Or are we guessing about both?

Dr. Yellen. Well, we're guessing about both things. The empirical estimates that were in the Berger study that showed there had been a roughly 35 percent decline in lending to small businesses were estimates. They were not hard and fast facts. In fact, we do not have data on small business loans prior to 1993.

So although the study was very carefully done, it was an attempt to guess at what had happened to small business lending, using data from another Federal Reserve survey on the terms of business lending.

The implications of the second study——

Mr. LaFalce. Because of this woefully inadequate data we had put legislation in to get better data.

Dr. Yellen. We do have data from 1993 on because of the new requirements to collect that data in the Call Reports, but we don't have data going back to 1989. Therefore, a rather sophisticated technique was used to try to look at what had happened from 1989 through 1994.

So it is a guess that lending to small businesses declined that much over that period, and you should recognize that a lot of assumptions went into that analysis.

I think it's important to realize that in 1994 and 1995 when we do have good data, there has been a very substantial pick-up in lending to small businesses.

Mr. LaFalce. Should we be that concerned, then, because not only are we engaged in sophisticated guessing with the hindsight, but we're also picking a period of time that corresponds to the worst time of the credit crunch.

Dr. Yellen. That's exactly right, too.

Mr. LaFalce. The passage of FIRREA and the most stringent regulatory oversight we ever had from the regulators, which discouraged lending.

Dr. Yellen. Yes. I would agree with you. Even if we had firm data that said that lending had decreased over the period that was studied, it is a further leap to attribute that to bank consolidation for exactly the reasons that you've given. A number of things were happening during that period—we had a recession, difficult conditions in the banking industry, and so forth.

So as I tried to point out in the testimony, for the last 2 years, where we do have firm data, we've seen a considerable increase in small business lending. As we look at reports from small businesses themselves on the availability of loans at this point——

Mr. LaFalce. Dr. Yellen, let's get off the Berger study. Let's go to the Kansas City Federal Reserve Bank study of 1995.

Dr. Yellen. All right.

Mr. LaFalce. That banks owned by out-of-State holding companies had a significantly lower ratio of small commercial loans to deposits than comparable independent banks, a 4.5 percent ratio of loans to deposits at banks with a high degree of branch banking versus a 6.3 percent ratio for independent banks. The study also found that branch banks had far less flexibility in making smaller loans.

Any comments on that study?

Dr. Yellen. Well, it's one study of many, and maybe I can mention a few other studies, many of which have been done in the Federal Reserve System. All that the Kansas City study does is suggest that larger banks tend to allocate a smaller fraction of their assets to small business lending.

If one wants to use that observation to make predictions about what the trend will be in small business lending that comes with

consolidation, that is a great leap. There's nothing that follows automatically from that observation.

What Berger did, just to go back to Berger, was to use essentially the same observation, that large banks have a smaller fraction of their lending to small businesses, and he went on and mechanically assumed that those fractions of lending to small businesses would stay constant as consolidation took place, and with these absolutely fixed allocation shares in different kinds of lending, went forward and projected a decline in lending to small businesses.

But I think you have to ask yourself whether or not it is a reasonable assumption to look very far into the future and to assume that these shares would remain constant. I think it's not a reasonable assumption. I think that banks respond to even small changes in profit incentives. There's no reason at all why these shares need to remain constant or would likely remain constant if there were even small movements in rate differentials. So I think that's a leap that's not fair to make in looking that far forward.

I think that type of projection also ignores the kinds of new technologies that are being developed, like credit scoring and securitization, that are bringing large banks more and more into the arena of small business lending, and we've seen simply anecdotal information that large banks do have interest in this lending.

When large banks acquire smaller banks that are active lenders to small businesses is it really reasonable to assume that if these are profitable lending opportunities, that the bank will simply get out of it? I would argue that it's not and that this may, in fact, be one motive for larger banks to acquire smaller banks to establish a more active presence in communities so that they can do small business lending.

I think the other thing I'd want to point out to you is that in addition to the Berger study and the Kansas City Fed study that you mentioned, there's other work also going on in the Federal Reserve that suggests this is a more complex issue that needs further study.

The New York Federal Reserve Bank also published a study recently in which they compared the behavior of small business lending at banks that were involved in mergers in the 1993–1994 period with the small business lending of banks that were not involved in mergers. Their study showed that merged banks increased their small business loans as much or more than banks that were not merged.

Another thing I would point out also is that we've observed in very preliminary work that we're doing at the Board that many mergers take place not just between very large banks and small banks, but small banks with one another or small banks with midsized banks.

Mr. LAFALCE. Dr. Yellen, I wonder if you could do me a favor, if you could present a written statement or summary of the various studies made within the Federal Reserve system impacting on this issue and give it to me. I would love to be able to give it to all the members of the Committee, too, who are desirous of having it.

Chair MEYERS. I think we would be interested in that.

Dr. YELLEN. I would be happy to do it. I'd just leave you with the thought this is a complex issue that we continue to study.

Mr. LAFALCE. So perhaps you could present some analysis associated with it. Thank you.

Thank you, Madam Chair.

Chair MEYERS. Mr. Suellentrop, would you like to comment?

Mr. SUELLENTROP. Sure, thank you.

First of all, I think it's important to point out in the discussion that you're right; you're talking about a time in '89 to '95 when there was a substantially different economy in terms of the business climate, but also there were 4,000 banks that were lost in the consolidations during that time.

Also, I think we need to define what is a small business loan because what's small business to me may not be small business to some of the larger banks. Our small business loans can be $10,000 but to some they may be $100,000 or $200,000 or $1 million and above. So I think it's important to define what type of loans we're talking about.

Certainly the consolidation has had an impact. We oftentimes get requests from small business customers, new and existing customers, for help because lending limits at larger institutions simply do not allow for their size of loan. So oftentimes we're looking at loans of less than $100,000 because they're not available from the larger financial institutions.

So I think it's important to make sure in our discussion that we're talking about the size of the loan, and not just a small business loan when we're talking about declines in numbers and dollars.

Chair MEYERS. Ms. Maltby, do you want to respond, to Mr. LaFalce's question?

Ms. MALTBY. Yes, just briefly. Thank you, Madam Chair.

As a $66 billion organization, our average small business loan is $37,000. We make over 30,000 small business loans a year. We think that the consolidation——

Chair MEYERS. Your average size is $37,000?

Ms. MALTBY. Yes, $37,000 within our small business program, which is to companies typically with sales of $3 million and under, so very community-based businesses.

Through over 100 mergers——

Mr. LAFALCE. Does that include or exclude credit cards used by businesses?

Ms. MALTBY. That excludes them. We're also——

Mr. LAFALCE. Are you sure about that?

Ms. MALTBY. Yes. We're also a very active small business credit card bank, as well, for businesses.

Through over 100 mergers of small banks, I think one of the comments that we hear from the bank owners as we bring them into the KeyCorp family is that they're able to actually serve their small business customers better because they can continue to have the community relationships that they've had when they were independent banks but now they're able to offer small businesses products and services that before the merger, they were not able to offer—sweep accounts that were in the past only available to Fortune 500 companies.

Credit scoring allows us to be much more competitive with pricing in offering credit opportunities to small businesses. Our advi-

sory boards and councils continually tell us that technology is driving their business and for us to be able to make banking easier through electronic and PC banking is important to community businesses.

So I think it's important to recognize that as long as a bank continues to focus on the small business business, community-based businesses, and not lose sight of their attachment to the community, as KeyBank hasn't, you can take the muscle of a large corporation, with technology, and use it for the benefit of very small businesses in America.

Chair MEYERS. Ms. Glassman?

Ms. GLASSMAN. I'd just like to add to what Sandy has said. In our practice we consult to financial institutions all over the country, mainly large ones, and we have seen the same kind of phenomenon in a lot of the large retail banks. They really are pushing to lend to small business. That's what they want to do. They're putting in the same types of programs, if they haven't already, that Sandy described.

So going forward, I think the assumption that the ratio will stay the way it was 5 years ago is just wrong.

Chair MEYERS. Thank you all very much. I think I will take my turn now.

I'd like to ask a question of Mr. Suellentrop and then anybody else who wishes to comment certainly can. How has the rise of nonbank lenders affected small banks' ability to lend to small business? In other words, have nonbank lenders taken a significant percentage of banks' market share for small business loans?

Mr. SUELLENTROP. They certainly, Madam Chair, have had an impact. In our area, in particular the Wichita, Kansas area, probably not maybe as demonstrated as some other areas of the country. It's a very competitive arena for financial institutions in the Wichita area and Kansas, with the banks, savings and loans, credit unions all striving to get their share of the market.

We do have a few of the nonbanking enterprises that are doing business there but in general, they're not a large part of the overall availability of credit. But they are, I think, a growing segment of the economy and a growing segment that we will continue to have to compete with as they expand their influence over the area that we serve.

Chair MEYERS. Thank you very much.

Ms. Glassman, would you care to comment on that? Has the rise of nonbank lenders affected small banks' ability to lend to small business?

Ms. GLASSMAN. There has been some increasing competition. Clearly, as I mentioned, The Money Store has been very active on the SBA side. Merrill Lynch has a very big push in small business lending. Because of the nature of their relationship with the small businesses to start with, they tend to focus on the better credit qualified small businesses, the ones with whom they have an asset management relationship or cash management relationship.

On the other hand, there are a lot of small finance companies that provide funding to small businesses. They tend to focus on factoring, accounts receivable financing, inventory financing, which are riskier, which are needed more by the high growth companies

and tend to be an area where the banks, so far, have been less active because they're very costly to monitor and require high rates.

But the environment is changing, with the changing technology making it easier to lend to the smaller companies at the higher risk levels. There is more interest on the nonbank part and we're certainly seeing entry into that business. The Fed study did show that there has been some shift toward finance companies, although the banks are still the most important lenders.

Chair MEYERS. Mr. Dowe?

Mr. DOWE. In Maine I think we see very little nonbank lending to small business. Our biggest competition in Bangor, Maine is KeyBank and I should say to Sandy that they really do an outstanding job of behaving like a community bank.

I think most of the people who we deal with are looking for more than a transaction. They're looking for a relationship with their bank. They're looking for a chance to have a deposit account, a cash management account, an employee benefit relationship, to get their home mortgage, to help their employees' get financing for homes and cars and things.

So we haven't seen the nonbank lenders in Maine and I think it's most because of that relationship aspect that we try to deliver to our customers and that they seem to appreciate.

Chair MEYERS. Thank you.

Our next questioner will be Mr. Luther.

Mr. LUTHER. Madam Chair, I have no questions.

Chair MEYERS. All right. Mr. Jackson?

Mr. JACKSON. Let me begin first by thanking you, Madam Chair and Mr. LaFalce, for the very kind introductory remarks welcoming me to the Small Business Committee.

I'd like to begin my questions, and anyone can feel free to respond to this. Small business is really the lifeline to economic activity within the minority communities around this Nation and obviously key to that is access to capital.

I want to share a little experience that I had last night which I, on the one hand, kind of regret because it affected my ability to get sleep, but on the other hand, prepared me for today's hearing.

I left my office last night at about 11 p.m., having determined that I had served my country enough for one day, and decided to go home. A staff member who happened to still be working asked me if I wanted a ride and I said no. I've come to regret that because after I left my office I saw my staff member drive by on their way home to get some rest.

I waited on the corner between the Longworth Building and the Cannon Building for a taxi, at which time two taxis passed me by. They were carrying no passengers and yet their lights were lit, giving me the indication that they were certainly looking for business.

I then assumed because I was wearing a dark navy coat that maybe they just didn't see me, so I'd walk over to the Library of Congress, between the Library of Congress and the Capitol, on that corner where it's a little more lit, only to find out that about 11 taxis ended up passing me, also, seven additional taxis that unfortunately had passengers. So 17 taxis passed me last night before one gentleman stopped to give me a ride home.

So when I think about that experience, redlining has obviously been a factor in determining that certain areas are credit unworthy and not worthy. There are areas in our country where the banks do not lend money and quite frankly, where banks do not lend money it's called a slum and it's called a ghetto.

I appreciated Mr. Dowe's testimony where he indicated that on four different occasions their bank made the determination to lend money to various individuals who were entering into business. I am of the opinion, however, that even with those great loans, they were highly discretionary on behalf of members of your bank to make those loans, based on clearly many of the determining factors that you indicated in your testimony.

I'm interested in knowing what creative lending programs the banking community can recommend or provide for minority-owned businesses, both male and female, both black and white, but in low-income areas where the lifeline in those communities are small businesses. They're not desirable businesses by mainline business in our Nation but there are people in these areas who may not have the kind of credit history, they may not have the kind of ongoing record that meet many of our procedures.

I'm just very concerned that many of our banking institutions at 11 p.m., because of some of their criteria, can pass by worthy people who are just trying to get home and get some rest.

So in light of that, I'd welcome a response from anyone. Madam Chair, thank you for the time.

Chair MEYERS. Thank you, Mr. Jackson.

Would anyone like to respond to this question of concern about loans to minorities?

Mr. HOVE. We, at the FDIC, certainly have a concern with lending in all areas of the community, as do the other regulatory agencies, and I can speak for some of the outreach programs that we have used at the FDIC in trying to encourage lenders to provide capital for minority areas, as well as other areas in the communities.

We've done a number of efforts throughout the country. We have sponsored expositions for small business or opportunities for small business to understand how they can borrow. We've also worked with lenders, to try to encourage lending to their entire community. We've worked with small business focus groups in areas such as Boston, the Native American areas in the Southwest, in South Carolina, Dallas, Milwaukee, Maryland and other areas like that in an attempt to both give the knowledge and understanding to the borrowers regarding how they can deal with a lender, and also with the lenders, with the banks,—encouraging them to make loans in these areas.

I think that all the agencies have tried to work very hard in the CRA effort, in looking at the performance rather than the documentation in CRA, to make CRA both more workable from the lender's standpoint and more friendly from the borrower's standpoint so that loans can be made available in the areas that you're very concerned about.

Mr. JACKSON. Vice Chairman, I appreciate that. I have no doubt that these Federal agencies are enforcing the law in their attempts

to provide the kind of capital for minority businesses and businesses in these low income areas that are necessary.

I'm of the opinion, however, that the rubber meets the road right where the loan officer meets the minority male or female who is applying for that loan.

Mr. Dowe talked about loan officers who they had confidence in, that they felt comfortable with and I wanted to know is there—maybe I should hear from some of the small bankers—what is it that they encourage these loan officers to look for, particularly as it relates to the changing dynamics in these inner city communities which, quite frankly, don't meet most of our criteria. Thank you, Mr. Hove.

Mr. DOWE. I'll just make two brief comments, Mr. Jackson. One is that Bangor Savings Bank in the communities that we serve have the highest approval rate of any bank in that particular area, and that's on the mortgage lending side. So I think that's sort of a fact that speaks to the aggressive nature of our lending in our community.

The second thing is that I think it's less, in my opinion, to do with laws and regulations and more to do with philosophy. Philosophically in our institution anybody and everybody is welcome to come in and apply for a loan and get the same kind of help. That's our approach. We want to welcome any customer or any prospective customer, regardless of race or color, and try to do what we can to help them succeed in their business or the purchase of their home.

Mr. JACKSON. Let me say, Mr. Dowe, and I'll yield back the balance of my time to the Chair, I appreciate the philosophy of your lending institution. I have no doubt that your lending institution is probably doing the right thing.

My biggest worry is that in many areas, to leave it solely to philosophy creates a problem in many urban areas. It certainly creates a problem in many areas that are determined, as a matter of philosophy, to be credit unworthy.

Let me yield back the balance of my time.

Chair MEYERS. Thank you, Mr. Jackson.

I have what I think will be a quick question—maybe not. I'd like to direct it to Mr. Hove and then we will go to Mr. Bentsen and then to Mr. Chabot.

I would like you to comment on the importance of the FDIC Call Report data that's collected every June. That is the information that has been used, I think, in all of these studies and that everyone has been referring to this morning.

Last summer there was some controversy in the Banking Committee regarding the data. Some Members wanted to abolish it. I think some banking people wish to abolish it and I was, of course, appalled and wrote a letter to members of the Banking Committee that said, "Please don't abolish this because we need to have this information to make sure that loans are going to small businesses." Mr. Hove?

Mr. HOVE. I'd be glad to respond. As Governor Yellen mentioned, this collection of data was begun in 1993 and each June after that. That's why I referred to the data and the comparisons between June 1994 and June 1995.

We are getting data now on the Call Reports. The concern, of course, is any regulatory burden and any reporting adds to the burden that the banks throughout the country have. If that information is duplicated in some other place so that it becomes a redundant report, certainly we would think that was unnecessary and I'm sure bankers would not want to report if it's redundant.

There is some indication that some of that data will now be reported under the CRA requirement. If that's the case, some of it may be redundant; some may not. But until we have good indications that it would be reported somewhere other than the Call Report data, we think it's important to be reported on the Call Report data.

If, in fact, it is redundant and is reported someplace else, then it doesn't seem to make sense to be reported in two different places for the same information.

Chair MEYERS. Well, this Committee would be the last one to want to have any more regulatory or paperwork burden on anyone. This seems to be a brief report and we wanted to make sure that that data was available to people since businesses with fewer than 20 employees created 57 percent of the new jobs last year. We think it's extremely important that all of us focus on the importance of lending to this group.

Would you like to comment, Dr. Yellen?

Dr. YELLEN. I would agree with Vice Chairman Hove's comments on this. I think we regard it as a very important data source and have tried to ensure that it would be collected in a way that would minimize the burden.

Chair MEYERS. Thank you very much.

Mr. Bentsen.

Mr. BENTSEN. Thank you, Madam Chair.

First off, I just want to clarify something that my colleague and friend Sue Kelly said on the Banking Committee and talking about the Federal Home Loan Bank bill and the Enterprise Resources Bank Act, I think is what we've renamed it, Chairman Baker's bill. We both sit on that Subcommittee.

I think she said you could pledge equity, small business equity against advance, and actually it's small business debt, and of course there's a big difference between debt and equity.

Now, there is another bill that we've had hearings on that Mr. Baker has introduced that's an equity bill, and I have some questions on that, as well.

It seems to me that there are four things in lending. I just had a conference last week with women business owners in Houston and we went through and wrote out a list at Rice University on the blackboard of different problems, not just related to capital but in capital, as well.

Looking at that and thinking about what's been said today, we have a problem of loan dispersion, which is what I think Mr. Jackson talks about, and whether you have redlining or whether capital is spread properly, a process in regulation that a lot of you all have talked about, both on the lending side as well as the Government side. Credit quality, which, of course, is something we always have to remember and sometimes forget, but it's certainly something that the FDIC thinks about quite a bit and the Fed.

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Then equity, that Dr. Glassman brought up, which is, of course, the $60,000 answer, I think, because equity is the toughest issue. I think in many respects we confuse the need for capital or confuse—misinterpret the need for capital to mean debt versus equity, and equity is much more difficult and the risks are far greater.

Let me ask a couple of questions, if I might. First of all, I've read earlier, and I've not followed up on this, that loan demand under the 7(a) program is down or was down for the first quarter of the year. I don't know if that's correct. It was something I read in the journal, as I recall. One of the reasons for that was that the fees were too high.

Now, on this Committee and in this Congress we did raise fees to try and make the program self-sufficient, which I support. I think it's a good idea, but I do have a question of whether or not that has become inefficient.

Do you all have any comment on that?

Ms. MALTBY. Mr. Bentsen, I can comment from our perspective. Any increase in fees will have obviously—could potentially have a negative impact on small businesses. We work very hard with entrepreneurs to give them the access to capital that they need and I think we look at the total pricing as it relates to giving credit to that entrepreneur in total.

So I think it not only has impacted the cost to the small business owner but the cost to the bank, as well, if we're compromising some of our fees to make an attractive package to an entrepreneur.

But at the same time I would say that when you look at the need for capital and understanding the SBA's position to provide more capital to the market, I think it was successful in doing that because some of the other moves that the SBA is doing in trying to make more loans to smaller businesses are really in support of the community businesses in the country.

So I think at KeyBank we've seen an increase in lending in the SBA program and it still supports a major source of capital for small business.

Mr. BENTSEN. Presumably the fees would be—when a borrower goes in and works with their lender, they're going to look at the fees and determine—they ask for the 7(a) Program versus some conventional lending program. Is that correct?

Ms. MALTBY. That's correct.

Mr. BENTSEN. Instead of versus no lending at all.

Ms. MALTBY. Yes.

Mr. BENTSEN. Governor Yellen and vice chairman Hove, the bill, I don't know the exact title but Chairman Richard Baker's bill which would allow for banks with assets under $500 million to use excess capital up to, I think, 50 or 30 percent of their excess capital to purchase equity in small businesses.

I don't know if you're familiar with that legislation or not but if you are, your colleague, Susan Phillips, testified on it the other day. I know the Fed, in its usual manner, has not taken an official position on this because the official position of the Fed is not to take an official position.

Could you comment on that and your viewpoints on that?

Mr. HOVE. Certainly I will. The bill is a very interesting bill and a very constructive bill and we have, in fact, responded in a letter

to Congressman Baker. It has some good potential. There are some concerns, of course.

When you talk about excess capital, certainly there's excess capital sometimes in very good times but as economies turn around and conditions deteriorate, excess capital can be a difficult thing to assess. It can present some liquidity problems for the institution in the event that the investment must be sold at a time that might not be advantageous for the institution to sell the investment that they have.

But basically I think we would agree that it has some potential, it has some possibilities, and we've indicated a willingness to work with Congressman Baker to try to work through some of the issues that we have concerns about.

Chair MEYERS. Thank you. I'd like to turn to Mr. Chabot for a couple of quick questions before we have to go vote and then I would ask Mr. Flake and Mr. Meehan if they would like to submit questions for the record or would you like to return after the vote?

Mr. FLAKE. Unanimous consent to submit questions for the record.

Chair MEYERS. Without objection so ordered. Very good. Thank you, Mr. Flake.

Mr. MEEHAN. I'd like to do the same, too.

Chair MEYERS. All right, thank you very much.

Mr. Chabot.

Mr. CHABOT. Thank you, Madam Chair. I'll be very brief because we do have a vote here.

Mrs. Maltby, I notice that you're from my State so I'll direct my brief questions here to you. I'm from Cincinnati as opposed to Cleveland, your area, but we're all from Ohio.

You mentioned a couple of things here, and I will take the time to read all the testimony from all the other panelists, as well, but a couple of things stood out when I was reviewing yours. On page 9 you had mentioned that your customers oftentimes do complain about too much regulation and too much paperwork and you mentioned one survey showed that 76 percent of the small business decisionmakers said they were very concerned about Government regulations, that nearly a third of their time was spent just filling out Government paperwork.

You mentioned this customer who said that he's under the jurisdiction of 11 different agencies and he says that when he's not complying with the regulations he sells irrigation equipment in his spare time. Very well stated, I think.

Briefly, if you could, what are a couple of the most egregious either agencies or forms or things which you can see the benefit is probably relatively marginal versus the amount of time that's spent on doing the paperwork? What would you change if you were up here, in other words?

Ms. MALTBY. First thing that comes to mind, and we're seeing improvements, I should add up front, but the first thing that comes to mind is a customer of ours that owns a chemical business and she needed to dispose of some chemicals. She wanted to comply with whatever Government regulation related to her chemical business.

First, just to identify what regulations she needed to comply with was very difficult and she wasn't sure where to turn to. So I forget which Government agency she actually called but she picked up the phone and started making phone calls. She couldn't find anybody that could specifically tell her what to do with it. It was a vial of chemicals and how to dispose of that.

After literally 30 days of making phone calls, she didn't know what to do. She said, "What do I do with the chemicals? Do I keep it in my office? Do I just throw it out?" She didn't want to do that. She estimates that she spent over $10,000 trying to figure out how to dispose of a vial of chemicals.

I think the concerns that entrepreneurs have are they want to comply; but they don't know how to find information on how to comply with Government regulation in general. I think they're just looking for an understanding of the unique situation that they're in when they are approached by a Government agency.

We had an accountant that was—one of his employees complained about a discrimination suit and if a Government agency shows up at his doorstep, he can't do what KeyBank does and go to one of our seven floors of attorneys to let them figure it out. He's got to stop his production and his business to address the Government official that happens to want an explanation on any of his personnel practices or policies.

So just a little bit of understanding on the unique situation on to part of small businesses.

Mr. CHABOT. Thank you very much. I think, in the interest of time, I'll yield back the balance of my time.

Chair MEYERS. Thank you very much, Mr. Chabot. We do have a vote now and rather than make you all wait for 15 minutes while we get over there and come back, I will now order this hearing adjourned.

We would like to submit some questions for the record and have you respond to them if there are Members who have further questions. This has been a very good hearing. I've learned a lot and I thank you all very much for being here.

[Whereupon, at 11:53 a.m., the Committee was adjourned, subject to the call of the Chair.]

APPENDIX

STATEMENT OF FLOYD H. FLAKE BEFORE THE HOUSE COMMITTEE
ON SMALL BUSINESS
MAY 1, 1996

CHAIRWOMAN MEYERS, I APPRECIATE THE OPPORTUNITY TO DISCUSS THE COMMERCIAL BANK'S ROLE IN PROVIDING SMALL BUSINESS FINANCING. IT HAS BEEN FOUND THAT COMMERCIAL BANKS ARE ONE OF THE MOST IMPORTANT SOURCES OF CREDIT FOR SMALL BUSINESSES. AS THE LARGEST PROVIDER OF CREDIT TO SMALL BUSINESSES, BANKS HAVE DISTINGUISHED THEMSELVES AS SUPPORTERS OF THE SMALL BUSINESS COMMUNITY. IT IS MY HOPE THAT BY EXAMINING THE OPPORTUNITIES AND CHALLENGES THAT BANKS FACE IN THEIR SMALL BUSINESS LENDING, WE WILL LEARN MORE ABOUT WAYS TO ADDRESS THE SMALL BUSINESS COMMUNITY'S CAPITAL NEEDS.

MANY SMALL BUSINESSES CREDIT THEIR FINANCIAL SURVIVAL TO THE CREDIT THAT MANY COMMERCIAL BANKS AND FINANCE COMPANIES PROVIDE TO THEM. SEVENTY ONE PERCENT OF BUSINESSES WITH TEN TO TWENTY EMPLOYEES, AND EIGHTY-SEVEN PERCENT OF BUSINESSES WITH OVER ONE HUNDRED EMPLOYEES USE BANK LENDING AS THEIR PRIMARY SOURCE OF CAPITAL. BECAUSE SMALL BUSINESSES AND BANKS ARE SO INEXTRICABLY LINKED, WE MUST EXAMINE HOW REGULATORY REFORM CHANGES SUCH AS SIMPLIFIED BANK

EXAMINATIONS, CRA COMPLIANCE PROCEDURES AND REPORTING REQUIREMENTS COULD ASSIST THE BANKING INDUSTRY IN BECOMING AN EVEN GREATER CONTRIBUTOR TO FINANCIALLY STRAPPED SMALL BUSINESSES. I HOPE THAT THIS HEARING WILL OFFER US A FORUM FOR DISCUSSING THESE ISSUES.

AS A MEMBER OF BOTH THE BANKING COMMITTEE AND THE SMALL BUSINESS COMMITTEE, I LOOK FORWARD TO DISCUSSING HOW WE CAN BUILD ON THE CURRENT SUCCESSES IN BANKS' SMALL BUSINESS LENDING AND EXAMINE HOW CHANGES SUCH A BANK CONSOLIDATION WILL AFFECT SMALL BUSINESSES' ACCESS TO CAPITAL. ACHEIVING A NEXUS BETWEEN THESE TWO COMMUNTIES IS CRUCIAL TO ECONOMIC GROWTH.

I WOULD LIKE TO THANK OUR WITNESSES WHO HAVE JOINED US TODAY AND LOOK FORWARD TO OUR DISCUSSION.

JAN MEYERS, KANSAS
CHAIR

JOHN J. LAFALCE, NEW YORK

Congress of the United States
House of Representatives
104th Congress
Committee on Small Business
2361 Rayburn House Office Building
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Statement of Rep. Jan Meyers (R-Kansas)
Chair
Committee on Small Business
U.S. House of Representatives

May 1, 1996

"Small Businesses' Access to Capital: The Role of Banks in Small Business Financing"

Good Morning. Our hearing this morning is the second in a series that this Committee is holding on small businesses' access to capital. At the first hearing on February 28th, we asked witnesses representing five prominent small business advocacy groups to address the current conditions and availability of capital for small businesses We wanted to know what specific obstacles and opportunities small businessmen and women currently face in this area

Those of you who attended that hearing will no doubt remember that much of the witness testimony and an even greater amount of the discussion focused on bank lending to small business. In general, the witnesses pointed to the difficulties of securing small-business bank loans and the demise of community bankers, which has led to weakening relationships between bankers and borrowers, as well as a decline in so called "character loans" The witnesses also noted that the high collateral and paperwork requirements that banks demand from borrowers, as well as various other regulatory barriers, present significant obstacles for small businesses seeking bank loans

Our witness' statements were underscored by a recent article in the March 14 edition of *American Banker* magazine, which cites a Federal Reserve paper claiming that between 1989 and 1994 bank lending to small business dropped 34%. The paper also predicts a 32% drop over the next five years. According to our witnesses, as a result of the declining role that banks are playing in small-business financing, many small businesses are turning to non-bank lenders and credit cards for their capital needs While these sources of capital are generally more expensive, they are also frequently more accessible.

As has been the case throughout this series of hearings, today we will examine the private market, rather than the government sponsored sources of capital There are indeed differing opinions with respect to how best to increase small business' access to capital. It is my

personal opinion that when appropriate, the government should encourage private-sector initiative in this area by removing whatever obstacles and disincentives that exist for banks to lend to small business, rather than simply increase the role of government sponsored capital sources.

I have asked the witnesses before us today to address the bank-lending issues raised by the witnesses at our first hearing. Specifically, I have asked the private-sector witnesses to identify the various impediments or disincentives that banks face in lending to small business. I have also asked them to assess how, despite the these impediments, certain banks have been successful in making small-business loans.

I have asked the regulatory witnesses to assess the overall regulatory climate for small-business bank lending. Are conditions today generally better or worse since the so called "credit crunch" of the early 1990's? In addition, I have asked them for suggestions to improve small-business' access to bank loans. Finally, I have asked today's witnesses to give us their opinions on the effects of industry consolidation and competition from other capital sources.

It is my hope that this hearing will give us a more accurate picture of the current state of bank lending to small business and help identify ways to improve small business' access to this important source of capital.

HOUSE COMMITTEE ON SMALL BUSINESS

FULL COMMITTEE HEARING ON SMALL BUSINESS' ACCESS TO CAPITAL: THE ROLE OF BANKS IN SMALL BUSINESS FINANCING

Opening Statement of Congressman Glenn Poshard

May 1, 1996

Madame Chairman, thank you for holding this next in a series of hearings on increasing the access to capital for small businesses in this country. As we all know, bank lending has traditionally been the largest source of capital for small firms, and the recent decline in loans from these institutions is cause for analysis. I appreciate your continued attention to these problems.

I would also like to thank our distinguished panel for joining us today and sharing their insights. There has been some concern, which I am sure will be addressed here today by Ranking Minority Member LaFalce and others, that the focus of this hearing may miss the crux of the bank lending problem. Substantial amounts of data seem to show that changes in the configuration of the banking industry, mainly mergers, are responsible for the inability of local firms to receive the level of credit they once did. The issues of regulatory and paperwork burden, while important, have received substantial treatment in this Committee and this Congress. Any new information on these topics is always welcome, but we must be careful to examine all factors that affect bank lending. Large, out-of-state banks have been more cautious in lending than smaller, community based ones. This matter deserves increased scrutiny.

Madame Chairman, that being said, it does not reduce your leadership role in this area. I would like to thank you again for your attention to these matters. I look forward to this morning's proceedings.

Testimony

of

America's Community Bankers

on the

Small Business Bank Lending

before the

Committee on Small Business

of the

U.S. House of Representatives

May 1, 1996

P. James Dowe, Jr.
Board of Directors
America's Community Bankers
Washington, D.C.

and

President
Bangor Savings Bank
Bangor, Maine

Chairwoman Meyers and members of the Committee, my name is Jim Dowe. I am President of Bangor Savings Bank, a mutual institution in Bangor, Maine. Bangor Savings has $715 million in assets and is an active lender to small businesses.

I am pleased to appear before the Committee on behalf of America's Community Bankers, where I serve on the Board of Directors. ACB is the national trade association for 2,000 savings and community financial institutions and related business firms. The industry has more than $1 trillion in assets, 253,000 employees and 14,500 offices.

ACB shares your concerns, Chairwoman Meyers, about the need to increase small business lending. ACB has long supported full funding of the Small Business Administration's 7(a) guarantee program and the appropriate development of a secondary market for small business loans. However, other regulatory and legislative impediments that banks face in lending to small business must be removed.

I would like to state at the outset that community banking is alive and well. Small business customers prefer to do business with their local community bank, where they know the people and have ready access when the need arises. Community banks provide a variety of targeted services to businesses including mortgage loans, equipment loans, credit cards, lines of credit, overdraft protection, and so forth.

Offering cash management services is vital in developing any small business relationship. A line of credit enabling a business to borrow when the need arises is also an excellent selling point. Credit card processing, from accepting merchant deposits to offering a corporate credit card and/or personal credit cards for the business principals, helps build an institution's image as a one-stop for business banking services -- an important aspect to promoting relationship business.

Successful Small Businesses

Small businesses prefer to borrow from local institutions because of the convenience and personal treatment they receive. Loans and related services are efficiently provided by local institutions that are well positioned to evaluate credit based on local markets and economic conditions. An "added-value" secret weapon for Bangor Savings Banks, and many community bankers, is intimate knowledge of our local business customers and their needs.

A portion of the business loans made by Bangor Savings are what might be described as "character loans." Our loans are to family business people we believe in and trust. Because our business is tied directly to the success of our market areas, Bangor Savings has a great interest in ensuring the vitality of the communities we serve.

Before discussing our specific recommendations, I would like to review briefly a few examples of small business lending by Bangor Savings. Generally, these are small family businesses that large out-of-state banks going by the book might not make. For example:

- We recently granted a very small loan to two women who wanted to start a hairdressing salon. Their salon had been part of a national chain but the women wanted to start their own store. That business is now doing quite well. Several factors went into the decision to grant these women the loan: they had been in this business for a number of years and as a result knew what they were doing. Most of all, they provided us with a cost breakdown -- one-and-a-half pages single-spaced that included $3.95 for a dust pan and $14.95 for a push broom. That kind of commitment showed energy, thoroughness, and thoughtfulness, i.e., pure character.

- In a small rural town north of Bangor, we financed a small loan to a local mother of two to acquire a local day-care center. She worked at the center, but the then-current owners had lost interest in the business. The determining factor in granting the loan was the woman's knowledge of that line of business. Most of all, however, we believed in her and knew instinctively that it was the right thing to do for her and the bank.

- In another small Maine town, a small toy company made wooden toys. A craftsman working for the company came to us wanting to buy the company. The craftsman had no prior business experience, but we made him a $42,000 loan, which included an operating line of credit. Since he bought the company, his business has boomed to the point that the new owner has been featured on television and in several magazines. We made the loan to him because he had the fundamental skills needed, understood the problems of the business, and how to solve them.

- Although it involved a government guarantee, I would like to mention briefly one additional loan to a company that makes canoe paddles. A business owner who had received a golden parachute from corporate America came to us with a proposal to buy this company. The individual had shown that he was very capable as a businessman but needed start-up capital. He therefore was a natural for a SBA guarantee. The company is now doing quite well and is the largest employer in a small rural Maine town.

What Can Congress Do?

A strong savings institution industry operating under a rational and supportive legal and regulatory regime is critical to providing continued support for community small business needs. ACB is concerned that Congress may be reluctant to address the major competitive issues facing the industry because it is performing so well. Congress should not be lulled into a false sense of complacency. It is precisely in this no-current-crisis environment that Congress should act in the long-run interest of the industry. We all recall the frenzied environment in which FIRREA and FDICIA debates took place. Congress now has the opportunity to act in a more orderly fashion.

ACB believes that Congress can, and should, act on several fronts to promote a more favorable competitive environment for depository institutions to serve the small business community. Congress needs to reconsider past actions and undo some of the intrusive laws and regulations that were put on the books in recent years. The goal, of course, is to reduce regulation consistent with safety-and-soundness for all institutions.

The following are ACB's priorities for congressional action:

a. Insurance Fund Premium Disparity

I want to mention briefly an issue that will profoundly affect the ability of many savings institutions to continue to serve the small business community. It is unfortunate that Congress did not include in the 1996 omnibus appropriations package language to solve the huge disparity in the deposit premiums paid by Bank Insurance Fund members and those paid by Savings Association Insurance Fund members. This is a problem that needs to be fixed at the earliest possible date. From my standpoint as a BIF-insured bank, I think the GAO, CBO, FDIC, Treasury, OTS, Federal Reserve and others did an excellent job in focusing attention on the BIF/SAIF disparity and the dangers that it presents to the financial system. All banks have a stake in a financially sound deposit insurance system, and the system is only as secure as its weakest link. The public does not differentiate between the two insurance funds administered by the FDIC, and neither should policymakers. To compete effectively as a banking industry, and to guarantee the integrity of the payment system and credit availability, we must stand together to promote the common interest, including a strong deposit insurance system. The viability of the industry and its role in serving local communities are at stake.

b. Regulatory Burden Relief

Congress should reduce the regulatory burden on depository institutions, consistent with safety and soundness. The work begun in the last Congress and continued in this one are meaningful steps toward reform that will help institutions serve their communities. ACB strongly supports the Leach-Bereuter bill in the House and the Shelby-Mack bill in the Senate. Both bills are designed to remove unnecessary red tape and duplicative paperwork that in recent years have been strangling lenders.

Compliance costs are significant because they represent monies not available for making community loans or developing new products and services. One of ACB's larger members reports that as a matter of everyday business, its compliance program requires that 22 of the institution's senior executives meet once a month for at least an hour and a half merely to coordinate the bank's response-to compliance requirements. This institution spends $4 million annually in direct compliance costs alone.

But this regulatory burden hits hardest on smaller institutions that cannot take advantage of economies of scale, and do not have a large staff of trained specialists to assure compliance with all regulations. Reducing the industry's federal compliance costs through a series of precise, technical improvements of the sort contained in these bills before the Congress would permit all financial institutions to divert resources now spent on compliance toward making loans and delivering savings products to the community instead.

Former FDIC Chairman Bill Isaac recently noted: "Competition and nationwide banking won't run community banks out of business, but the government might." By passing much needed regulatory burden relief, this Congress can refute that scenario and improve small business lending.

c. Small Business Lending

One means of expanding lending opportunities for small business would be to relax the commercial lending limit for federal savings associations. Under current law, federal savings associations may not invest more than 10 percent of their assets in commercial loans. Over the years, some federal associations have become sufficiently involved in business lending to bump against this ceiling.

ACB strongly supports the provision in the Senate regulatory burden relief bill (S. 650), sponsored by Senators Shelby and Mack, that would increase the 10 percent cap on assets invested in commercial loans to 20 percent, provided that loans in excess of 10 percent be invested in small business loans. The bill would also permit savings institutions to count small business, credit card and student loans toward meeting the qualified thrift lender test. This provision would afford institutions some additional leeway to make business loans and enhance the institution's full-service community focus.

d. Environmental Lender Liability

There remains a major obstacle to lending for small businesses that requires attention-- secured party liability under environmental laws. Legislation to clarify that lenders that come into possession of property are not liable for environmental cleanup costs passed both the House and Senate during the last two Congresses but was not enacted into law because of disputes over larger issues.

Congress must act to restore the intent of the Superfund law and Solid Waste Disposal Act by clarifying that lenders, trustees, fiduciaries, government agencies and others who make secured loans or act as fiduciaries are not liable. The benefits are clear-- small businesses including those in the inner-cities are adversely impacted by genuine fear of open-ended environmental liability on the part of lenders. Clarification of the Superfund exemption for secured parties will enhance the flow of credit and reduce the cost of credit to small businesses and assist them in undertaking private clean-ups of hazardous waste problems.

e. Examination Issues

The scope and frequency of both safety and soundness and compliance examinations can impose excessive direct and indirect costs on institutions. The direct cost is the time spent by an institution's personnel to satisfy examination requirements. The indirect cost is the time and resources that are diverted from productive activities. A cost-effective allocation of examination resources is essential for institutions and their examiners. We all understand cycles of business and the effect of both a downturn and rapid expansion in the market. Banks need a pattern of consistent examiner standards if banks are to maximize their ability to make loans available to small business.

f. Sweep Accounts

By federal statute, businesses may not earn interest on demand accounts. This unnecessarily restricts the ability of businesses, both small and large, to manage their monies to their best advantage and prevents depository institutions from providing the most efficient and profitable cash management services to their business clients.

Under current regulations, however, institutions may use "sweep accounts" to move corporate funds from non-interest bearing demand accounts and into interest bearing non-deposit accounts and back again. Regulation D limits institutions to six "sweeps" from interest-bearing accounts per month or per statement cycle. Unfortunately, even using these "sweep arrangements," small businesses and smaller institutions are at a competitive disadvantage viz-a-viz their larger brethren who have access to Wall Street and other sophisticated mechanisms for corporate cash management.

Permitting the payment of interest on business demand accounts would provide small businesses with a needed tool to assist them in one of the most fundamental of their concerns, management of their cash flows.

g. Loan-to-Value Ratios

Loan-to-value (LTV) limits are lending standards for all insured depository institutions. The specific LTV limits are restrictive, however, for small business and start-up businesses. They fail to take into account the diversity of lending practices of lending institutions, the health of lending institutions, economic conditions in the local lending area, and the individual circumstances surrounding the request for credit. We suggest that the federal banking regulators consider in their efforts to reduce the regulatory burden, as called for in Section 303 of the Riegle Community Development bill, allowing well-capitalized or otherwise well-performing institutions when lending to small business to use greater flexibility in judging the creditworthiness of a borrower, market conditions and other credit quality factors.

h. Directors' and Officers' Liability

Most small business owners could use expertise on their boards of directors or advisory groups to enhance oversight and corporate decision making. Director's liability insurance is costly, and may be out of reach to many small businesses. Were it not for the fear of personal liability in this litigious environment we are in, more people would be willing to take an active role in the small business community.

i. Education

As a society, we generally do a poor job of educating our next generation of small business owners as to the required skill sets they will need to succeed in business. Universities and colleges are striving to address the shortfalls in this area but much more needs to be done. While it is important that our current graduates understand how to take a company public and the various capital markets, more time is needed in the more basics of small business. Meeting a payroll, dealing with vendors, break-even analysis, capital requirements and performing basic marketing are but a few examples where more work is needed. There is a wide array of resources available to assist small business but, in most circumstances, when the need is realized, it is too late.

Conclusion

Chairwoman Meyers, and members of the Committee, everyone wants to spur small business lending. Small business lending is at the core of American job creation. Sound and competitive savings institutions, unhampered by excessive regulatory constraints, can play a major role in providing profitable financial services for a growing economy. ACB members want to be in the business of devoting their full energies to investing in their communities and lending to small businesses, not to be in paperwork purgatory.

America's Community Bankers stands ready to assist in any way possible to address these issues. I will be happy to answer any questions you may have.

FURASH & COMPANY

Statement of

Cynthia A. Glassman
Managing Director
Furash & Company
Washington, D.C.

Regarding

Bank Lending to Small Business

Before the
House Small Business Committee

May 1, 1996

Madame Chairman and members of the Committee:

I appreciate the opportunity to provide my views on the current environment for small business financing, especially as it relates to bank lending. Small business financing is an area on which I have focused for much of my career. My experience in this area includes: staff advisor to the Treasury Department's Small Business Advisory Committee; the economist responsible for small business issues at the Federal Reserve Board; conducting research studies on bank lending to small business while at the Fed and as a consultant; and, in my current position as a Managing Director at Furash & Company, consulting with financial institutions on small business issues.

As I am sure you are aware, legal restrictions make it very cumbersome for banks to provide equity capital to small businesses, either directly or through underwriting. Those restrictions are an impediment to the ability of small businesses to raise capital. However, since you have asked me to address bank lending to small business, not their ability to raise equity capital, I will limit my remarks to the following topics.

- The current environment for bank lending to small business and how it has changed since the so-called "credit crunch."
- Regulatory impediments or disincentives to bank lending to small business.

- The rise of nonbank lenders to small business and the effect on credit availability to small business.

Overall, the current environment for bank lending to small business is excellent. Banks are healthy; their capital positions are strong; and earnings for the industry as a whole have hit record highs for the last four years. In addition, in recent years banks have been "asset hungry", and have been looking for ways to leverage their liquidity. Further, technological advances have reduced the cost of small business lending, enabling banks to expand the population to which they can cost-effectively make loans. Also, new reporting requirements and increased focus on making small business loans in the new Community Reinvestment Act (CRA) guidelines provide additional encouragement to banks to lend to small businesses. Combine these factors with a growing economy and a better outlook for business overall, and you have the basis for banks being willing and able to lend to small business. As a result, competition is intense. And, according to National Federation of Independent Business (NFIB) surveys, credit availability is not a significant issue for its members.

This environment contrasts markedly with the environment during the "so-called" credit crunch of the early 1990s. During those years, the banking industry was <u>not</u> healthy. Over one thousand banks failed between 1982 and 1992. Problems in the economy and commercial real estate in particular resulted in severe credit quality problems for banks. Consequently, a large percentage of their earnings had to be used to build up loan loss reserves. At the same time, as

the Federal Deposit Insurance Corporation Improvement Act (FDICIA) was being debated, and ultimately enacted, banks had to improve their capital to assets ratio. There were (and are) only two ways to accomplish this: increase capital or decease assets. With earnings weak and the market not particularly enamored of banks at the time, significantly increasing capital by retaining earnings or issuing new equity was not easy. Therefore, many banks had to shrink assets, or at least keep growth to a minimum. That meant limiting lending activity. Overlay that with bank and regulator concerns about borrowers' credit quality given the state of the economy, and it should have been no surprise that bank lending in general, and to small businesses in particular, was not going to be strong.

Despite the much improved environment, there are still concerns that small businesses face serious obstacles in obtaining bank credit. Many of these concerns were raised at this Committee's earlier hearing. Before addressing these issues, I would like to make two key points:

- First, not all small businesses are credit-qualified—for example, startup businesses; businesses with weak earnings or poor management; or a business in a declining industry may not qualify for bank credit, no matter how good the lending environment is.
- Second, a bank's primary business is to lend money—and to get paid back. A bank's incentive is to make a loan as long as the loan is profitable on a risk-adjusted basis.

At your earlier hearing, the issues raised included:

- The impact of consolidation.
- The demise of character loans.
- Current regulatory impediments.

There is no question that the pace of bank acquisitions and mergers has picked up steam in the last several years, on the order of 500 or so mergers a year. I expect this pace to continue, resulting in about 5,000 banking organizations at the turn of the century, down from the 7,500 in existence now (measured by owning entity). First, I will briefly explore the reasons for consolidation; then I will discuss the impact on small business lending.

There are several explanations for the consolidation trend.

- Banks are now permitted to consolidate. It was not so long ago that interstate banking of any kind, i.e., through a holding company or a branch, was not allowed. In fact, in many states, branching and/or multibank holding companies were not allowed. In other words, consolidation was constrained by legal and regulatory barriers.
- Although difficult to measure empirically, there appear to be economies of scale and scope in at least some banking activities,

including management and operations, which are an incentive to consolidate.

- Technology has facilitated efficient operations in a broad geographic scope thus enabling banking organizations to effectively manage and operate a geographically diverse distribution network.
- Like many U.S. companies in all industries, banks have been looking at ways to increase efficiency; in-market mergers offer the potential of eliminating redundant offices, staff, and systems.

One of the frequently cited concerns about the impact of bank consolidation is that it replaces community banks with larger organizations that do not serve small businesses well. I am sure there are some large banks that do not treat small businesses as well as the businesses would like, just as I am sure that there are also some small banks that do not meet the needs of their small business customers. And there have been some banks that have not handled customer relations very well in the merger process. Bankers are people too, and, unfortunately, they do make mistakes.

However, in recent years especially, many of the large retail banks have made small business banking a key strategic initiative. They have realigned their organization structure to create units that focus on small business; dedicated staff specifically to serve small business customers; established financial incentives for developing small business customers; streamlined their credit process, including using credit scoring models; and introduced products tailored to meet

small business needs such as cash management accounts and PC-banking. The data demonstrate this large bank activity in small business lending. Banks with assets over $1 billion are responsible for the majority of commercial bank loans to small business.

It is true that large banks' ratios of small business loans to assets tend to be lower than small banks' ratios. All that says, however, is that large banks serve more constituencies than small banks. A significant portion of large bank loans goes to middle-market and large corporate loans that are also needed to keep the economy healthy. Small banks do not have the capital to safely support these large commercial loans.

Turning to character loans, they are less prevalent than they used to be, for good reason. No matter how much a business owner wants to repay a loan, if the business does not generate earnings and cash flow, or have the collateral to support the loan, the business owner cannot repay, despite his or her good intentions. The experience of the late 1980s proved that to bankers and their regulators. "Character" indicates willingness to repay. Of course willingness to repay is important, but ability to repay is critical.

This brings me to regulatory impediments. The apparent belief is that if regulators evaluate each individual loan in their bank exams, then banks will be less willing to take on risky loans even if they are priced appropriately. In our experience, the regulators are moving away from loan-by-loan reviews, and are more willing to consider small business loan risk on a portfolio basis. In fact,

their whole exam focus is shifting to the overall ability of the bank to manage comprehensive risk across all lines of business and functional areas.

One final area I would like to address is nonbank competition for small business loans. Simply put, it is increasing and is likely to increase more. Major sources of credit for small business are noninstitutional; they include suppliers, who provide what is called trade credit; family and friends; and credit cards. Of the institutional lenders, banks are clearly important, but nonbanks have made substantial inroads. According to the Federal Reserve's 1993 survey of small business finances, 37 percent of small businesses had a credit line, a loan, or a capital lease at a bank. However, 19 percent had such a borrowing relationship with a nondepository institution, mainly at a finance company or leasing company. These nondepository institutions are particularly strong competitors in asset-backed financing — e.g., vehicle and equipment loans and capital leases. The Money Store, a finance company, is the largest SBA lender, and has been for several years. Merrill Lynch's small business loans outstanding reportedly have grown to close to $1 billion and, according to a Consumer Bankers Association recent survey, 58 percent of respondents consider Merrill Lynch to be their third largest competitor after regional and community banks. In sum, both bank and nonbank competition for small business loans is strong and growing.

To reiterate, the small business lending environment is quite hospitable these days. The market is working.

TESTIMONY OF

ANDREW C. HOVE, JR.
VICE CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

ON

CREDIT AVAILABILITY FOR SMALL BUSINESS

BEFORE THE

COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

10:00 A.M.
MAY 1, 1996
ROOM 2359, RAYBURN HOUSE OFFICE BUILDING

Madam Chairwoman and members of the Committee, I am pleased to have this opportunity to testify before you today on behalf of the Federal Deposit Insurance Corporation (FDIC) on the issue of credit availability for small business. My testimony will discuss recent trends in small business lending; our analysis of the potential impact on credit availability of increased consolidation of the banking industry; and ongoing efforts to reduce regulatory burden by streamlining regulations and coordinating the supervisory process.

Background

When I last appeared before you in April 1993, the recession of the early 1990's was ending and the FDIC had just begun to see the first signs of increasing strength in the economy and increasing demand for credit from households and businesses. At that time, the banking industry was attempting to resolve the large number of remaining troubled assets from the 1980's. Bank lending to business had declined in virtually every quarter throughout the 1990 to 1992 period.

During this period, the industry devoted more attention to eliminating leftover problem loans and shoring up troubled balance sheets than taking on new lending risks. Consequently, many banks tightened their underwriting standards and became more selective in their lending. Many borrowers were unable to meet

the more selective underwriting standards because real estate, which traditionally serves as the primary source of collateral to support small business borrowing, either had declined in value or was not appreciating as fast as it once had. Thus, borrowers had difficulty providing the equity needed to obtain bank financing. Moreover, the low interest rate environment combined with the unusually steep sloping yield curve then existing made medium-term U.S. Government securities a very attractive investment alternative for banks.

By the first quarter of 1993, however, the industry was well positioned to lend. Over 95 percent of the BIF-insured banks were well capitalized, liquidity levels were high, and the FDIC estimated that the industry as a whole could support asset growth of $500 billion and still remain well capitalized.

Current Trends in Small Business Lending

Since my 1993 testimony, the banking industry has demonstrated continuing strength. Commercial banks have attained record high earnings and have maintained both high liquidity and capital levels. Last year saw commercial banks achieve record earnings for the fourth consecutive year. This strong earnings performance was also broad based as two-thirds of all commercial banks reported higher earnings for the year. Similarly, at the

end of 1995, the equity capital ratio for commercial banks stood at 8.11 -- its highest level since 1941.

The strength of the banking industry over the past three years has been accompanied by increased lending to small businesses, although lending to small borrowers has not recovered to pre-recession levels in real terms. Between midyear 1994 and midyear 1995, loans by FDIC-insured commercial banks to small businesses and small farms increased by $23.6 billion or 6.8 percent. Significantly, during that period, loans secured by commercial real estate to small businesses grew at a faster rate than such loans to larger businesses (7.5 percent _versus_ 4.5 percent). Figure 1 to my testimony depicts the growth in the dollar amount of various categories of loans to small businesses and small farms between midyear 1994 and 1995.

Small banks always have been a major source of credit for small businesses -- and this role continues to be important. This is confirmed by the FDIC's data for midyear 1995. While commercial banks with assets of less than $1 billion accounted for 56.1 percent of the total dollar volume of loans to small businesses and small farms, smaller banks with less than $300 million in total assets alone accounted for 42.4 percent of the total dollar volume of such loans. Another reflection of the important relationship between small banks and small businesses is the fact that banks with assets of less than $100 million

granted over 96 percent of their business loans to small businesses and small farms. In contrast, banks with assets of $1 billion to $10 billion granted 36.6 percent of their business loans to small businesses or small farm borrowers. Banks with assets of greater than $10 billion granted only 19.5 percent of their business loans to small businesses and small farms. A detailed breakdown of these data is shown in Table 1. Larger banks, however, have recently begun to expand lending to small businesses through their installment loan departments. This development offers the propect of additional credit being available to small businesses.

Consolidation of the Banking Industry

Given the important role that small banks play in extending credit to small businesses and small farms, some observers have expressed concern regarding the availability of credit to this sector if industry consolidation trends continue. For example, some have pointed to the one-third decline during the past decade in the number of banks with assets below $1 billion as a cause of concern. The arrival of nationwide interstate banking and branching may add momentum to industry consolidation.

If only the decline in the number of smaller institutions is considered, the future prospects of this segment of the banking industry, and by extension the availability of credit to small

businesses and small farms, might seem unpromising. However, the mere decline in the number of smaller banks does not provide a complete picture. The 1980's and early 1990's saw an unusually high number of bank failures. As a consequence, the numbers of all categories of banks declined and fewer new banks opened. This trend has abated. Last year, only six commercial banks failed -- the fewest since 1977. Last year also saw the number of new bank charters more than double from 1994. This trend has continued into 1996 with the opening of 29 new banks during the first quarter.

Banks with less than $100 million in assets remain the most numerous category of institution. As of December 31, 1995, there were 6,659 commercial banks in this category, accounting for two out of every three FDIC-insured commercial banks. More than 95 percent of all insured commercial banks have less than $1 billion in assets. Although institutions with less than $100 million in assets together represent only 6.8 percent of industry assets, they held 22 percent of all loans to small businesses. They operate in over 4,000 cities and towns in which there are no offices of larger banks, providing essential financial services to consumers and businesses.

Small institutions have demonstrated the ability to thrive in both large and small markets. While smaller banks may not have the financial resources to service major corporate customers

to the same extent as larger banking institutions, smaller banks have certain advantages in working with smaller, local businesses. Their necessary focus on the local community has enabled small banks to specialize in extending credit to small businesses and small farms. Indeed, small institutions have flourished in states such as California, New York, and Virginia where statewide branching has been allowed for many years. The FDIC expects this to continue.

The recent performance of small commercial banks also does not offer any reason to doubt their future. In three of the last six years, banks with assets of less than $100 million were more profitable than the industry average as measured by return on assets (ROA). In 1994 and 1995, more than 95 percent of these institutions were profitable. Almost two-thirds (64.4 percent) reported ROAs above one percent, and more than four out of five (81.8 percent) had ROAs above 0.75 percent. They have the lowest proportions of troubled assets of any asset size group.

Although the trend toward consolidation in banking appears likely to continue, data on bank performance suggest that the smaller banking organization focused on service to a particular local community and taking advantage of competitive strengths resulting from that focus can continue to prosper.

In summary, smaller banks remain an important and strong source of credit to small businesses. Available data indicate that bank consolidation and the removal of geographic restrictions on U.S. commercial banks will not eliminate the role played by small banks. The removal of geographic restrictions should yield important benefits to the banking system, small-business borrowers, and to the nation's economy. First and most importantly, geographic diversification will tend to promote a safer and sounder banking system. It will help make bank asset quality and income more stable, and thus better enable banks to withstand regional recessions and meet credit needs in times of stress. Second, geographic diversification will give banks an opportunity to structure themselves more efficiently, eliminate duplicative functions, and reduce expenses. Third, it will encourage competition by making it easier for institutions to enter markets that are not now fully competitive. Because of the importance of banks as sources of credit for small businesses, we expect that small businesses will benefit from the improvements in the banking system that will accrue from interstate branching.

Although commercial banks historically have been the principal providers of financing to small businesses, they are not the sole source of credit. A 1993 survey of small business financing, which was cosponsored by the Federal Reserve Board and the U.S. Small Business Administration, revealed that approximately 95 percent of small businesses obtained financing

from depository sources, including commercial banks, savings institutions and credit unions.[1] At the same time, nondepository financial sources were used by just under 30 percent of the firms. Small businesses used finance companies most often, followed by brokerage firms and leasing companies. Nonfinancial sources of credit were used by 15 percent of small businesses. Although only one percent of small businesses reported using government sources, this percentage understates the role of government. Many entities, such as the U.S. Small Business Administration, provide important credit guarantees. These data indicate that additional sources of credit do exist for the small business borrower.

Regulatory Initiatives

Throughout the early 1990's, the regulatory agencies issued numerous statements intended to clarify supervisory policy and reporting requirements. The statements were an attempt to remove impediments to bank lending that might occur due to unnecessary costs or supervisory burdens. For example, the statements clarified supervisory standards on the classification of real estate loans and on the importance of flexibility in working with borrowers with temporary financial problems. The purpose of

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[1] Rebel A. Cole and John D. Walken, "Financial Services Used by Small Business: Evidence from the 1993 National Survey of Small Business Finances," Federal Reserve Bulletin, July 1995, pp. 629-67.

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these statements was to help ensure that lenders and borrowers would not be discouraged by regulatory requirements and misunderstood examination policies as the economy developed momentum and credit demand accelerated.

When I testified before the Committee in 1993, the FDIC had joined the other bank and thrift regulators in announcing a joint program to address the problems of credit availability, especially for small and medium-sized businesses and farms. The program addressed five areas: 1) lending to small and medium-sized businesses and farms, 2) real estate lending and appraisals, 3) paperwork and regulatory burden, 4) appeals of examination decisions and complaint handling, and 5) examination processes and procedures. Since 1993, the FDIC has addressed each of these areas.

Lending to Small and Medium-Sized Businesses and Farms

The first initiative announced under the interagency program was a new joint policy statement. Under this policy statement, the strongest banks and thrifts, that is those rated CAMEL Composite of "1" or "2" and which were at least adequately capitalized, were able to make and carry some small and medium-sized business and farm loans with only minimal documentation. The total amount of such loans at an institution was limited to an amount equal to 20 percent of its total capital. The loans

were to be evaluated solely on the basis of performance and to be exempt from examiner criticism of documentation. Six months after issuing this policy statement, its provisions were extended to those well and adequately capitalized state nonmember banks rated a CAMEL composite of "3."

Before lenders could begin to utilize this program fully, however, improvement in the general economic climate contributed to increased lending to small businesses. Nevertheless, this program was the first of several steps the regulators have taken in recent years to improve the ability of banks to make credit available more efficiently.

In addition, in August 1995, the agencies approved an interim rule to reduce the minimum capital levels insured institutions must maintain for certain small business loans and leases that are sold with recourse. This action implemented Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994.

Real Estate Lending and Appraisals

In June 1994, the four regulatory agencies announced the final revisions to the rules on real estate appraisals. This was one of the most important of the bank regulatory initiatives because it was designed to reduce costs and encourage lending

without compromising bank safety and soundness requirements. The major changes involved increasing the loan threshold for which a certified or licensed appraisal is required to $250,000, from $100,000; exempting from the appraisal requirements business loans of $1 million or less where the sale or rental of real estate is not the primary source of repayment; and expanding the "abundance of caution" exemption for business loans so that an appraisal would not be required when the collateral value is not material to a loan decision.

Regulatory Burden Reduction

Over the years, a number of new laws and regulations affecting banks have been adopted. While these laws and regulations were adopted to protect consumers and the deposit insurance funds, the cumulative effect has been to impose additional costs on financial transactions that are essential to sustain a vibrant and competitive economy. The burden of the additional costs has fallen disproportionately on insured banks as compared to other types of institutions thereby resulting in competitive disadvantages. Moreover, regulatory burden in general has a disproportionate effect on smaller institutions which are the primary lenders to small businesses.

The reduction of the burden imposed by unnecessary and cumbersome regulatory requirements is critical to the ability of

smaller banks to compete effectively with larger banks and non-depository financial companies. Regulatory relief is a major initiative that the FDIC has undertaken. Regulators should constantly look for possibilities for reducing burden and making the supervisory process more efficient and must guard against implementing new policies that might unnecessarily impede the lending process.

In 1992, I directed a review of each FDIC regulation, policy statement and program in order to identify and accelerate action on initiatives that would eliminate any unnecessary burden or otherwise promote economic growth. This review resulted in a number of recommendations aimed at reducing regulatory burden and several reforms were adopted. For instance, the FDIC executed an agreement with the Conference of State Bank Supervisors as well as the Office of Thrift Supervision covering the coordination of examinations of financial institutions. In another instance, the four federal banking agencies agreed (under the auspices of the FFIEC) to announce prior to the end of each year all reporting changes to the Call Reports that will take effect in the following year. The banking agencies also discontinued the designation and reporting of "highly leveraged transactions" and the FDIC agreed to accept a copy of the chartering authority application as a means of applying for deposit insurance.

To implement the Riegle Community Development and Regulatory Improvement Act of 1994, the FDIC also is currently reviewing 120 regulations and policy statements. Our mandate from Congress is to reduce regulatory burden by streamlining regulations where practical and by achieving uniformity among federal regulators on common issues. As Chairman Helfer testified in May 1995 before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Banking and Financial Services, in order to focus our reviews, the FDIC is testing its regulations against three specific criteria: (1) whether the regulations are necessary to ensure a safe and sound banking system; (2) whether the regulations enhance the functioning of the marketplace; or (3) whether the regulations can be justified on strong public policy grounds related to consumer protection.

The FDIC will report on our progress to the Congress in September, but we have made significant progress thus far. Among our accomplishments, we have implemented an automated assessment collection process; decreased the number of real estate loans that require an appraisal; increased the flexibility of our audit regulations; adopted flexible standards for safety and soundness; and revised CRA standards to provide more objective, performance based assessment standards to minimize compliance burdens.

Appeals of Examination Decisions and Complaint Handling

The FDIC also is mindful that regulatory burden may be associated with the examination process. Both the FDIC's Division of Supervision (DOS) and the Division of Compliance and Consumer Affairs (DCA) have taken, and are continuing to take, steps to identify areas to be streamlined in safety and soundness and compliance examinations. We believe that the best way to identify these areas is to ensure that there are open lines of communication with bankers. In 1995, the FDIC created the Office of Ombudsman. This action established a formal procedure for gathering unrestricted input from agency and industry personnel and for identifying outdated, ineffective or inconsistent policies, regulations, procedures and practices. The Office responds to inquiries and complaints in a fair, confidential and timely manner and serves as an agency contact point for the banking industry. It is also a central point for public inquiries and complaints.

The FDIC also has established an appeals process for material supervisory determinations made by agency examiners and regional supervisory officials. This program sets forth guidelines for an institution to appeal examination ratings and other determinations that may have an effect on an institution's capital, earnings, operating flexibility or otherwise affect the nature and level of supervisory oversight accorded the

institution. Institutions may file appeals with the special Supervision Appeals Review Committee established in the Washington Office. This Committee, which is composed of myself, as the Vice Chairman of the FDIC, the Director of Supervision, the Director of Compliance and Consumer Affairs, the General Counsel, and the Ombudsman considers and decides the appeal, and notifies the institution of its decision within 60 days.

In addition, the FDIC inaugurated a nationwide informal outreach program in 1995 designed to solicit bankers' opinions and suggestions on how to improve the quality and efficiency of both the safety and soundness and compliance examination processes. The program is aimed at detecting and improving aspects of the examination process that may have been burdensome or inefficient. Following an examination, banks are surveyed on their opinions about the appropriateness of the examination procedures, the quality of the examination team, the usefulness of the examination report, the size of the examination team, and their preference for having other specialty examinations done separately or at the same time as the safety and soundness examination. These surveys have indicated that banks are generally satisfied with the examination process. In response to bankers' comments in the surveys, a number of changes have been made to existing examination procedures. For example, a minimum lead time was established for contacting bankers of upcoming

examinations and the on-site examination hours were reduced by shifting certain examination functions outside of the bank.

I believe that these initiatives, taken as a whole, have created a climate that is more conducive to lending and eliminated some misunderstandings that had existed in the industry. The relationship between increasing credit availability and reducing regulatory burden, however, is an indirect one that is not easy to measure. Although it is almost impossible to isolate and allocate the improvement in the lending climate between reduced regulatory burden and a generally improving economy, both factors have contributed to improved opportunities for small business lending.

CONCLUSION

Since my testimony before this Committee in 1993, significant progress has been made in improving the availability of credit to small businesses. The improvements in the health of the banking and thrift industries during that period have led to increased lending to small businesses and small farms and a concomitant expansion in resulting economic activity. Small to medium-sized banks are the backbone of lending to small businesses and small farms. As has been well reported in the media, the banking industry has continued its long term

consolidation. Nonetheless, it does not appear that the future viability of the small and medium sized bank is in jeopardy. The strong profitability of such banks compared to larger institutions demonstrates that small banks have certain competitive advantages and continue to fulfill a valued role by focusing on the credit needs of the local community.

The FDIC, and the other federal bank and thrift regulators, also have taken major steps during this period to review existing regulations and supervisory and examination policies in order to reduce regulatory burden. The FDIC is continuing this process in order to ensure that our regulations enhance the functioning of the marketplace, while helping to maintain a safe and sound banking system and provide for consumer protection. We will continue to work with the Congress, as well as bankers and the communities they serve to ensure that the FDIC fulfills these goals.

This concludes my prepared testimony. I would be happy to answer any questions.

Figure 1

Growth in FDIC-Insured Commercial Bank Loans to Small Businesses and Small Farms June 30, 1994 through June 30, 1995

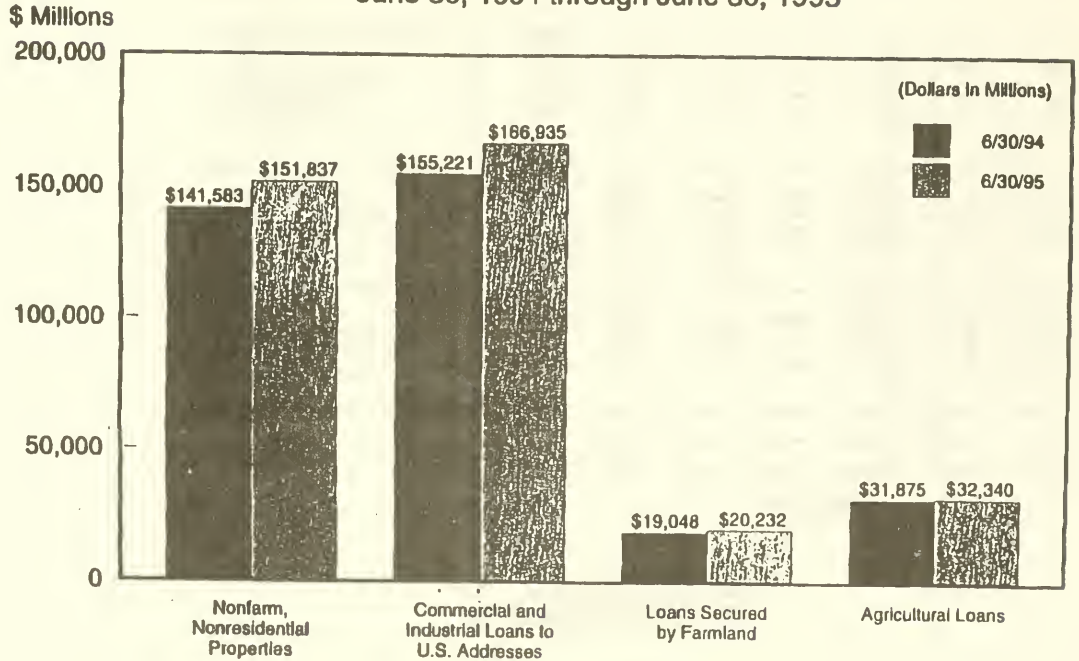

TABLE I

FDIC – INSURED COMMERCIAL BANK LOANS TO
SMALL BUSINESSES AND SMALL FARMS
BY ASSET SIZE FOR JUNE 30, 1995
DOLLAR AMOUNTS IN MILLIONS

		Amount of Loans Asset Size Distribution					
		Less than $100 Million	$100mm to $300mm	$300mm to $500mm	$500mm to $1 Billion	$1 Billion to $10 Billion	Greater than $10 Billion
Total Loans to Small Businesses and Small Farms	371,344	81,084	75,803	28,010	25,169	86,837	74,131
Nonfarm Nonresidential Loans							
Less than $100,000	33,830	11,414	8,188	2,203	1,951	6,827	3,148
$100,000 through $250,000	32,539	4,735	7,108	2,730	2,870	8,416	6,681
$250,000 through $1,000,000	85,767	8,597	17,068	7,118	7,873	24,283	20,931
Total	161,888	24,746	33,858	12,051	12,494	38,420	30,761
All Nonfarm Nonresidential Loans (Sch. C)	281,876	26,119	41,349	17,396	20,720	88,408	87,884
C&I Loans to U.S. Addressees							
Less than $100,000	87,447	18,073	14,809	4,378	4,125	13,850	11,701
$100,000 through $250,000	31,783	3,959	5,607	2,256	2,310	9,215	8,141
$250,000 through $1,000,000	67,708	4,767	8,097	4,491	4,774	22,053	21,734
Total	186,938	27,289	30,508	11,226	11,209	45,178	41,578
All C&I Loans to U.S. Addressees (Sch. C)	519,210	28,240	35,451	15,701	19,303	145,061	275,454
Loans Secured by Farmland							
Less than $100,000	13,177	8,238	3,040	660	286	807	148
$100,000 through $250,000	4,250	1,677	1,198	341	218	572	244
$250,000 through $500,000	2,805	902	761	215	195	474	258
Total	20,232	10,817	4,999	1,218	699	1,853	648
All Loans Secured by Farmland (Sch. C)	23,649	11,074	5,507	1,419	971	2,890	1,788
Agricultural Loans							
Less than $100,000	22,004	16,604	4,866	943	425	1,655	408
$100,000 through $250,000	4,592	1,892	1,132	336	165	906	342
$250,000 through $500,000	3,543	1,146	737	238	157	870	395
Total	32,340	18,742	6,737	1,517	767	3,431	1,146
All Agricultural Loans (Sch. C)	40,077	19,276	7,371	1,815	1,147	6,376	4,097

TESTIMONY OF

SANDRA MALTBY

SENIOR VICE PRESIDENT
SMALL BUSINESS SERVICES
KEYCORP

on behalf of

KEYCORP
and
THE SMALL BUSINESS COUNCIL
of the
UNITED STATES CHAMBER OF COMMERCE

presented to the

COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

May 1, 1996

TESTIMONY OF

SANDRA MALTBY

Senior Vice President
Small Business Services
KeyCorp
May 1, 1996

I. Introduction

Madame Chair:

On behalf of KeyCorp and the Small Business Council of the United States Chamber of Commerce, I would like to thank the Chair and the Committee for this opportunity to discuss the new role of banks in small business lending. My name is Sandra Maltby, and I am Senior Vice President in charge of Small Business Services at KeyCorp, and a member of the Chamber's Small Business Council.

I hope to explain that "small business and banks" is no longer a one-way street where small business needs banks more than the reverse: The credit needs of America's entrepreneurs have merged with the changing structure of the financial services industry to make small business an indelible and an evermore important customer for our industry.

I hope to illustrate these points by discussing KeyCorp's approach to small business banking. I will also comment, from a banker's perspective, on the general regulatory atmosphere impeding even a strong bank's effective response to the credit needs of small and new businesses.

KeyCorp, which is headquartered in Cleveland, is the nation's second largest lender to small businesses. It is also one of the nation's largest bank holding companies, with $66.3 billion in assets at December 31, 1995. We are a national, bank-based, consumer and commercial financial services company, with more than 1,400 offices in 26 states, stretching from Maine to Alaska.

We define "small business" as enterprises with annual sales of $3 million or less and with credit needs of $300,00 or less. We have over 86 million small business loans outstanding to 375,000 customers. These amount to a $3.3 billion portfolio. The number of these loans increased almost 14 percent from the year before, and their dollar amount grew nearly 11 percent.

Key, in fact, has been among the top three small business lenders for a number of years – working, to name a few, with lobster fishermen in Maine, florists in Utah, apple growers in Washington State and office supply distributors in Anchorage, Alaska. We have, in short, deep commitment to, and long experience in, meeting the credit and business needs of entrepreneurs and growing businesses.

In this work we have learned five principles about small businesses:

- First, of course, these enterprises need unimpeded access to credit;

- Second, success, however, depends on more than capital: executives must have a full range of value-added services – from retirement plans, to advice on topics as disparate as personnel management, regulatory requirements and sales management, to referrals to accountants, lawyers, etc.;

- Thirdly, it is decidedly in our interest as a lender that our customers be informed and astute managers in the optimum operation of their enterprises;

- Fourth, entrepreneurs are different: they need to be able to bank on their own terms – when and how it is convenient, using products and services tailored to their needs;

- Fifth, they need to work with bankers who are local, who are knowledgeable about them, their business and about the issues common to growing companies.

Out of these principles and our experience has evolved the Key model for small business banking. It is an approach which attempts to address the twin issues of access to capital and access to knowledge and skill. Furthermore, we submit, this model reflects the expanding role of small businesses both in our society and in the constellation of bank priorities.

The result, we believe, is a strengthening, not a weakening, of the relationship between bankers and borrowers.

II. The Emerging Model of Small Business Banking

Access to Credit

Access to credit is, of course, the pivotal concern behind these hearings. Frankly, it is *the* perennial challenge for a financial institution committed to small business.

First, by their very nature, small business, unlike their more established brethren, do not always walk into the bank with detailed financial histories and resources. Second, small business, like their larger brethren, have good times and bad.

Given that banks are not high risk lenders, how can we make our credit actions match our rhetoric? How can we provide access to credit, yet not put our depositors' investments at risk, when the applicant does not fit, for whatever reason, a banker's perfect profile of credit worthiness?

My answer, unfortunately, is not a magic key to credit for all applicants. But it flows from those five principles, and reflects the emerging re-orientation of the

banking community to small businesses: *Entrepreneurs are different and banks must adapt to that reality.*

For too long we have viewed small businesses as miniature big businesses. We are learning to modify the ways we make credit decisions to reflect the advantages in the nonstandard attributes and balance sheet the entrepreneur presents.

Several years ago we had a loan customer in New York State who had been rejected by two community banks for a $60,000 loan to open a restaurant. We were able to secure the loan by looking outside the traditional criteria, using his life insurance policy as collateral. Such flexibility and ingenuity is becoming more common and is, as I will explain, driven by basic changes in the banking industry.

Access to Skills and Broader Banking Services

Entrepreneurs, as I have said, need more than loans. At Key we have organized our small business services to deliver capital, skills and banking services. We have seven strategies targeted to small business:

- First – Customized Financial Solutions – Everything from different kinds of checking accounts, financing and leasing options, investment vehicles, retirement services, payroll services, business checking accounts – well over 100 different products.

Small businesses have unique and challenging financial needs and they are not the same as those of our retail or larger commercial customers. We need to match what we sell to what customers need and want – not fit them to us.

Just last week we opened our first "KeyCenter" – a branch designed and dedicated to small business, in Columbus, Ohio. Staffed by specially trained personnel, it has a mix of personal computer-based resources to help entrepreneurs adopt strong management practices.

The "KeyAdvisor," for example, is a computer kiosk at which entrepreneurs can calculate cash flow, liquidity and debt ratios and track financial history. By the way, an advisory panel of Midwestern small business owners helped us design the center's services.

- Large Corporation Services Tailored to Small Business – We now offer smaller firms, for example, the same cash management services, leasing arrangements and "EDI" – electronic data interchange – the electronic vendor payment systems which large corporations use, but which small firms find too expensive;

- Information Resources – Newsletters and self-study brochures (for instance, ones on "Affordable Marketing Techniques," "Time Management" and "Employee Motivation");

- Mentoring Programs, in which KeyCorp employees – from our banking experts to computer system pros – will help small business owners tackle a problem;

- Our 24 hour Small Business Resource Center, which gives account information and referral to small business resources; and

- Networking Opportunities – So that small business owners can learn from one another and from industry experts.

A bank's customers are an impressive resource of experts on almost any field imaginable. The irony is that banks have had these resources at hand for decades – we have just not thought in terms of using both our internal business expertise and that of our customers to help other customers.

- Advocacy – KeyCorp can help small businesses get their voices heard in support – or in opposition to – government proposals or regulations.

A firm's success in its communities and markets often depends on effectively delivering its message to legislators and other decision-makers. Banks have the resources and stature to help do that. For example, a year ago, KeyCorp brought more than 100 customers to Washington, D.C. for a two-day conference to meet with U.S. Senators, Cabinet Secretaries, and Small Business Administration officials.

We also sponsor-a national *KeyCorp Survey of Small Business Sentiment* survey twice a year to monitor small business sentiment. What are your major concerns? How do you feel about the direction of the country?

In our most recent survey, for example, we found much more optimism for the future than we had previously. Almost two-thirds of small business owners we surveyed felt their revenues will increase (though those in business fewer than 20 years are more optimistic than those in business longer.)

- Finally, we have a Small Business Certification Program – We train our employees to be experts on small business products and needs, and on how to serve as consultants and advisors.

Note that these are services banks can offer small business which have nothing to do with lending. However, they *expand and redefine* the relationship between banker and entrepreneur.

Indeed, key to my argument today is that banks and small business are in the midst of a mutual redefinition of their relationship. Banks are expanding their sense of business customers – and entrepreneurs are expanding their sense of what a bank can do for them.

Yet these are natural steps for a bank to take – because of who we are, the resources we bring to bear and where our industry and small business is heading in the world economy.

III. The Merging Worlds of Small Business and Banking

I would argue that structural changes currently transforming the American economy and the banking industry itself will permanently place small business as core to banking's future.

The Emerging Dominance of Small Business

While it is repeated as dogma so often one begins to doubt truth – small business has become a fundamentally dominant force in the American economy as it never has been before:

- Since 1970, a fundamental shift in the American economy has shifted the most productive parts of the economy to smaller and small enterprises;
- The Global economy has forced U.S. companies to produce higher value goods with fewer, better trained workers – propelling small business job growth;
- Over the past 25 years, two-thirds of the *net* new jobs in the private sector originated among small firms.

The results for the U.S. economy as a whole are startling –

- America's 21 million small businesses employ more than half the entire workforce in America;
- Small business created *80 percent* of all new jobs in America;
- Small business accounts for more than 54 percent of all sales and 53 percent of all employment;
- Small businesses generated 39 percent of our gross domestic product.

The Converging Interests of Small Business and Banking

Over much the same period as small business has been growing in importance to the national economy – the last 30 years – banks have lost much of their dominance of the financial marketplace. Those shifts have also helped bring banks and small businesses together.

- Banks' share of all financial assets held by financial institutions has dropped almost in half, from 40 per cent in 1973 to 25 per cent in 1993;

- Commercial lending at large U.S. banks – historically the core of the banking business – has dropped from 65 per cent of the total short term borrowing of non-financial companies to 36 per cent;

- Banks' share of business credit shrank from 45 per cent in 1980 to about 30 per cent by the third quarter of 1993. This is while total business credit in the U.S. *grew* from $2 to $3 trillion;

- In 1983, the U.S. had three of the world's largest 20 banks in assets; today, no American bank is in the top 20. (The closest is Citicorp, at 29)

Banks' New Competitors

Banks today must compete with nonbanks, such as Sears, American Express and General Electric. We must do so in mortgage servicing, trust services, discount brokerage, data processing, securities underwriting, real estate appraisal and credit life insurance.

In short, a number of historical forces have heightened the importance of small business to commercial banks. Furthermore, with the prospect of continuing defections of traditional markets to nonbanks, brokerages and mutual funds, "The only arena in which banks may continue to have a clear advantage [over non-banks] is in lending to small firms," writes Mark D. Vaughn, an economist with the Federal Reserve Bank of St. Louis in the most recent *The Regional Economist.*

IV. The Question of Regulatory Impediments

The logic of the transformation of the financial services industry draws small business and commercial banks closer together. Key's new customer-centered approach to small business banking is one vessel through which this new relationship will be carried forward. But, regrettably, that vessel must still navigate the choppy seas of burdensome and often unclear paperwork and regulation.

From the bank's side, the issue today is not specific regulations that are burdensome. The efforts at simplifying and eliminating rules and restrictions at a number of agencies with banking industry oversight seem to be paying off.

What is left, ironically, in the absence of too much detail, is often too little. We often must operate with a lack of clarity about what's expected and an uncertainty about when we may be crossing some line we shouldn't.

Our customers, however, do complain about too much regulation and paperwork. In a recent KeyCorp Small Business survey, 76 percent of the small business decision-makers who responded said they were "very concerned" about government regulations. Nearly a third said they spend more than 20 percent of their time filling out government paperwork. That's one full day out of the work week.

Bob Gillespie, Key's President and C.E.O. often cites a client of ours from Idaho who listed 11 agencies, both federal and state, that regulates his business. When he's not complying with regulations, Gillespie quips, "He sells irrigation equipment – in his spare time."

Our suggestion would be that, in the same way as governments have worked to simplify the regulatory mandates facing banks, they need now to do the same for our customers.

V. Conclusion

In sum, whether banks play the role of lender, advocate or educator, small business have evolved into important and invaluable customers – and we are beginning to treat them that way. We are, by design, becoming key *resources* -- plural -- for small business.

Through the decades of rising competition and consolidation, commercial banks have always known that their secret weapon was our location: we are rooted in the community. We are in your neighborhoods. That closeness gives us the knowledge to help build America's small businesses. Historical forces have given us the incentive.

APPENDIX

I. KeyCorp's Blueprint for Small Business Services

II. Fourth Survey of Small Business Sentiment

III. KeyCenter Press Release

IV. "How a Giant Wooed and Won the Entrepreneur's Business" *The Wall Street Journal* April 17, 1995

Key's Blueprint for Small Business Services

KeyCorp has earned a distinctive reputation among this vibrant and growing segment of our economy. Going forward, Key strives to be "America's First Choice for Small Business." Key plans to achieve its first choice position by combining superior customer knowledge, business solutions and convenient access to services.

Superior knowledge means understanding each customer's industry, market, "state in life," and small business strategy better than any other competitor. Key Small Business customers are served by Small Business Relationship Managers who are trained to use consultative profiling techniques to identify and satisfy the unique needs of each customer. As their relationships grow, customers are recognized and rewarded. Through programs like local Small Business Advisory Boards, customers are asked to provide regular feedback that can be used to improve our performance -- to their satisfaction. Key also listens closely to small businesses through frequent advocacy and networking initiatives.

Business solutions that work means offering competitive products tailored to meet the needs of small businesses. It means providing a comprehensive set of products that satisfy all of a business's financial needs. It means designing services that are simple to understand and use. It means marketing these products as flexible offerings from which customers can choose those which best meet their individual needs, and it means continually innovating to find new solutions as the needs of the small business community evolve. Key's Small Business Services provides a variety of products customized to meet the needs of small business owners, from 401(k) plans to cash management services and check access lines of credit.

Finally, convenient access to services involves providing a single point of contact for all relationship needs using a variety of delivery channels. Sales and service at the local level are delivered through outlet-based Small Business Relationship Managers who are rewarded for building full-service relationships. Customers are also able to use their telephones to access the 24-hour, personalized service and information offered by KeyCorp's Small Business Resource Center. ATMs and personal computers will further extend our options for convenience banking. Rigorous, customer-defined quality service standards help ensure customer satisfaction.

Success is measured by deposit retention and growth, a higher cross-sell ratio and increased loan outstandings and market. Currently, KeyCorp is the second largest small business lender in the country.

KeyCorp's Fourth Survey of Small Business Sentiment

Key Findings & Methodology

OVERVIEW

KeyCorp's Small Business Services sponsors this bi-annual survey to stay in touch with the concerns of small business owners throughout the nation. The results from fourth "Survey of Small Business Sentiment," which are summarized below, were released on November 7,1995.

KeyCorp understands the challenges of running a small business and has developed products and services to help. "We at KeyCorp believe that relationships don't begin or end with a loan or checking account; far more important is the ongoing dialogue that continues long after the loan application," said Sandra Maltby, senior vice president and manager of Small Business Services at KeyCorp.

METHODOLOGY

The fourth wave of the KeyCorp Survey of Small Business Sentiment was conducted by The Wirthlin Group in late September, 1995. This survey is based on a representative cross section national sample of owners/managers of companies with annual sales between $1 million and $3 million. The sample represents industries in approximate proportion to their representation in the business population as a whole. A total of 430 business heads were interviewed. Minority-owned businesses were oversampled in order to provide a subsample of 100 minority-owned business respondents for separate analysis. Interviewing was conducted between September 11 and October 2, 1995. Sample error for the total sample is ±5 percent at a 95 percent confidence interval, which means that in 95 out of 100 cases a survey of this size will produce responses within ±5 percent of the result that would have been obtained had the entire universe of businesses of this size and industry composition been interviewed.

SMALL BUSINESS OWNERS PREDICT REVENUE GROWTH

Small business owners see an increase in their revenues in the coming year. This is consistent with the favorable economic forecast they predict for the country as a whole, within the next 12 months. Growth will occur while businesses stay lean. The majority of small business owners anticipate maintaining their current level of staffing in the same time period.

Almost two-thirds (61 percent) of small business owners feel that their revenue will increase in the coming year, while about one-third (31 percent) say it will remain the same.

- There is more optimism regarding changes in company revenue in the next 12 months from small business owners who have been in business 20 years or less than those who have been in business longer. About seven in ten (67 percent) of the former see company revenues increasing in the coming year, compared to half of those in business over 20 years (52 percent).

- Start-up businesses (those in business five years or less) predict the most significant revenue increase --this group anticipates an average growth of over 50 percent in their revenues. Those is business longer are more conservative -- those in business between six and 20 years see an average revenue increase of 26 percent, while those in business over 20 years foresee an increase of 13 percent.

Six in ten (59 percent) small business owners predict the economic outlook for the country will become more favorable within the next 12 months, or remain the same (13 percent). One quarter (25 percent) see the economic environment becoming less favorable.

- Small business owners in manufacturing and service industries are more optimistic about the economic outlook of the country in the coming year than their peers in other industries. Seven in ten (70 percent) see the economic environment becoming more favorable in the next 12 months, compared to only slightly over half of those in the wholesale/retail trade industry who feel similarly (54 percent).

The average number of employees in these small businesses is 19. While employee cutbacks are not foreseen in the future, small business owners believe the pool of qualified labor is shrinking. The majority (58 percent), therefore, say they will retain their current level of employees in the coming year. In comparison, only 38 percent say they will increase their staff. However, those who say they will increase their staffing will do so in a big way -- they anticipate increasing their staff by an average of 23 employees.

- A majority (60 percent) of small business owners in business five years or less expect to expand their employee base in the future, while most of those in business longer expect their level of employees to remain the same in the coming year (68 percent of those in business over 20 years and 54 percent of those in business between six and 20 years).

SMALL BUSINESS OWNERS EXPECT ECONOMIC GROWTH

In the coming year, the majority of small business owners project either an improvement in their opportunities for economic growth, or at the very least, having the same opportunities they had this year. Many feel positive about their regional economy, which is good news, since they see this as a primary factor in creating a favorable environment for their business.

Over eight in ten (82 percent) small business owners expect economic growth opportunities for small business to increase or at least remain steady within the coming year.

- Minority small business owners are slightly less optimistic -- only seven in ten (71 percent) feel similarly, and over one quarter (27 percent) feel opportunities will get worse.

The majority (72 percent) of small business owners feel that compared to other regions of the country, their region is either better off or the same as others.

- Over half of Northeastern small business owners (53 percent) feel that their region of the country fares worse than others. This is in marked contrast to other regions where the majority of respondents say that their region either fares better or as well as others (South 90 percent, Midwest 90 percent, West 68 percent).

Having a strong regional economy is a primary factor for creating a favorable small business environment, say 79 percent of small business owners (who rate this 4 or 5 on a 5 point scale). Other important factors are access to capital (71 percent) and access to a qualified labor pool (65 percent).

- Having a strong regional economy is seen as more important to small business owners in service industries and the wholesale/retail trades than those in manufacturing (80 percent vs. 63 percent). As would be expected, small business owners in service industries also view having access to a qualified labor pool as one of the key attributes for a successful small business, more so than their colleagues in other industries (79 percent vs. 61 percent in wholesale/retail and 55 percent in manufacturing).

- Women small business owners are more likely to feel that access to capital is key to contributing to a favorable small business environment (83 percent vs. 69 percent of male small business owners).

- Operating in a strong regional economic environment is of paramount importance to small businesses, according to Midwesterners, who feel this is by far the most important factor (90 percent rate this 4 or 5 on a 5 point scale). Seven in ten small business owners in other regions feel similarly.

OPTIMISM INCREASES AMONG SMALL BUSINESS OWNERS

As the economy and the business environment has changed over the past 18 months, the outlook of small business owners has become more favorable. Compared to Spring 1994, many small business owners currently express more confidence and optimism about running their business, the prosperity of their region, and about the economic environment in general.

- Compared to one year ago, small business owners currently feel that the region of the country where their small business is located is slightly better off than other regions in the country (47 percent say this today, compared to the 40 percent who did so one year ago).

- Compared to Spring 1994, small business owners today are much more optimistic regarding their predictions for economic growth opportunities for small businesses in the future. In fact, since last year, this optimism has been steadily increasing. This fall, four in ten (41 percent) say they think opportunities for expansion will get better in the next year, whereas in Spring 1994, only one fourth (26 percent) felt similarly. Correspondingly, today, less than half as many small business owners say growth opportunities will get worse in the future compared to a year and a half ago (16 percent vs. 38 percent).

- Running a small business seems to have gotten easier over the past year and a half. Today, twice as many small business owners say it has gotten less difficult to run their business over the past year, compared to Spring 1994 (10 percent vs. 5 percent). In fact, 18 months ago, more small business owners felt that running their business had gotten more difficult over the past year (62 percent vs. 52 percent who feel so today).

ADDITIONAL HIGHLIGHTS

Industry:

- More small business owners in manufacturing foresee growth opportunities for small businesses getting better in the coming year than do those in other industries (57% vs. 45% service and 40% wholesale/retail trade). In fact, over one fifth (21%) of those in wholesale/retail trade see opportunities getting worse (compared to 6% in manufacturing and 15% in service).

- More small business owners in wholesale/retail trade feel that finding skilled, qualified employees has gotten harder (67%) than their colleagues in other industries (53% in service and 49% in manufacturing).

- Small business owners in the service industry are more likely than those in other industries to favor the existing tax structure than the proposed flat tax (20% vs. 12% wholesale/retail trade and 6% manufacturing).

Years in Business:

- Interestingly, compared to those in business for a number of years, small business owners in business less than five years feel that running their business this past year has become less difficult than previously (21% vs. 11% of those in business between six and 20 years and 6% of those in business more than 20 years).

- Small business owners in business for less than 20 years feel more optimistic than those in business over 20 years that opportunities for economic growth will get better in the coming year (47% vs. 33%).

News

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KEYCORP TODAY CONTINUES TRANSFORMATION OF ITS U.S. OFFICE NETWORK BY LAUNCHING KEYCENTER DEDICATED TO SMALL BUSINESS IN COLUMBUS, OHIO

'Generic' branches to give way to four types of KeyCenters designed around target customer groups

Small business center will provide customized resources, specialized associates, high tech workstations

COLUMBUS, OHIO, March 13, 1996 -- Declaring that the generic U.S. bank branch is overdue for major change, KeyCorp (NYSE:KEY) today unveiled its first financial-services specialty center here. The KeyCenter -- which will feature services, associates, and technology designed for small business owners -- is one of four types of resource centers the nationwide company will launch over the next two years customized around target customer segments, their lifestyles and particular financial needs.

"Key and Society banks won't be 'one-size-fits-all' any longer," said Robert G. Jones, KeyCorp executive vice president for community banking. "We are changing with our customers, and that means redesigning our facilities and delivery methods around *their* lifestyles and evolving financial needs. We're erasing the term 'branch' from our company vocabulary -- both literally and in the way we do business."

Located at 1990 E. Dublin-Granville Road on the north side of Columbus, the KeyCenter looks and functions more like a learning center than a 1970s-style bank branch. Teller stations, a vault, and window signage announcing the latest free gift for a personal checking account do not dominate the facility.

Rather, the 4,700-square-foot facility features a mix of PC-based resources for entrepreneurs, associates specialized in all aspects of operating a successful small business, video screens, self-directed kiosks with popular PC software and informational material, and complete 24-hour telebanking services.

The facility will also offer Key's latest services and technologies for personal banking needs of the customers who currently use the facility.

KeyCorp, a $66 billion financial services company based in Cleveland, last year selected three cities to launch prototypes for redesigned financial-services centers: Syracuse, New York; Seattle, Washington; and Columbus. Besides the small-business customer segment, other KeyCenters are being designed for three other target groups: Mature, emerging affluent, and the mass market.

Other KeyCenter prototypes are being launched in Syracuse and Seattle over the next three months. After several months of monitoring customer reaction and results, Key will begin rolling out more of the specialized KeyCenters across its 13-state network in the fourth quarter of 1996, Jones said. With a network that spans four regions from Maine to Alaska, Key operates the largest geographic system of any U.S. bank holding company.

Jones said that not all of the 26 Key banks in the Columbus area -- or nationwide -- will undergo such extensive changes. "All of Key's community banking activities, however, will be impacted to varying degrees by the changes the company is making in its approach to business," Jones added. He cited Key's launch of new financial-planning products, 24-hour services by phone and PC, and development of specialized associates as examples of changes the company is making under its 'First Choice 2000' blueprint for the next four years.

"This transformation has as much to do with providing the people with the best expertise at our KeyCenters as it does with physical facility changes," Jones said.

A team of about 20 Key managers from offices around the country worked nonstop in Cleveland for eight months last year to develop plans for the four prototype centers based on customer feedback, demographic and sales data, lifestyle needs, and their collective experience in some of the top-performing Key offices in the U.S.

Why Columbus?

"The size, consumer demographics, and market growth rate of Columbus prompted Key to select it as one of the three pilot cities," said Tim Dixon, Columbus District president for Society Bank. "Society Bank also ranks first among Ohio banks in small-business lending, and our state ranks among the top 10 nationally in terms of the density of small businesses. Society's Columbus District has enjoyed twenty years of growth and strong performance, as well." (In Ohio, Key banks presently operate under the Society Bank name, but will change to KeyBank about midyear.)

On a national basis, KeyCorp ranked among the top three U.S. small-business lenders in analyses published by The Wall Street Journal and American Banker for 1994 and 1995.

"Driving the changes at KeyCenters in Columbus and around the country," said Dixon, "will be customer lifestyles, demographics and preferences in each market, overlaid with our overall focus on four primary customer groups for our retail business. Replacing generic offices with custom KeyCenters, specializing our associates, and offering 24-hour technology options are core implementation steps of Key's larger First Choice strategic plan that moves us away from trying to be 'everything to everybody.'"

Dixon added that Key and Society Bank remain committed to their excellent track records of community reinvestment and as equal opportunity lenders.

KeyCorp, headquartered in Cleveland, Ohio, is one of the nation's largest bank holding companies, with $66.3 billion in assets at December 31, 1995. KeyCorp provides consumer banking and finance, investment management and trust, corporate and investment banking, securities brokerage, private banking and customized financial services to individuals, businesses and other institutions through more than 1,400 offices in 26 states.

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TRUTH IN SMALL-BUSINESS LENDING

How a Giant Wooed and Won The Entrepreneur's Business

By STEPHANIE N. MEHTA
Staff Reporter of THE WALL STREET JOURNAL

Restaurateur Al Pollock was skeptical when a colleague suggested that he seek a small-business loan from a New York unit of KeyCorp, the giant Cleveland banking company.

Two small community banks had rejected his $60,000 loan application to buy an East Greenbush, N.Y., eatery. He figured a big bank would be less likely to make the loan. "I thought I was going to run into another dead end," Mr. Pollock says.

Instead, he hit pay dirt. A Key Bank of New York executive secured the loan by using Mr. Pollock's life-insurance policy as collateral. Key Bank officials "were the only ones who really talked to me and tried to make the loan go through," adds Mr. Pollock. He used the money to buy Teagan's T&T Steak and Seafood restaurant last fall.

Such tenacity has helped make KeyCorp one of the nation's leading small-business lenders. An analysis of federal banking reports shows that as of June 1994, KeyCorp's 13 commercial banking units had $5.8 billion in small loans, defined as loans up to $1 million. That represents nearly 43% of the bank's domestic commercial, industrial and nonresidential real estate-backed lending. KeyCorp, which now has 14 banking units, ranks third among large domestic banking companies in small-loan activity, in both total volume and in small loans as a percentage of domestic business lending, according to the analysis.

KeyCorp's success contrasts sharply with the relatively poor track records of numerous rivals that promote themselves as friends of entrepreneurs. Its small-loan volume exceeds the combined small-loan portfolios of Citicorp, Chemical Banking Corp. and Chase Manhattan Corp., whose combined domestic assets are more than four times greater than KeyCorp's.

KeyCorp, with about $61 billion in domestic assets as of last June, manages to make many small loans—and make money on them—through a combination of corporate strategy and coincidence, says Sandra Maltby, its senior vice president for small-business services.

Many of KeyCorp's branch banking offices, located in 14 states, operate out of former community banks in small towns. In acquiring those banks, KeyCorp inherited many of their loans and relationships with local businesses, Ms. Maltby says. The big banking company also has worked to retain and woo small-business clients while reducing the cost of making small loans, analysts and competitors say.

KeyCorp handles small-business lending through its retail division, which usually serves personal banking needs, rather than through its commercial-lending department. This fairly novel approach, used increasingly by big community and regional banks, can reduce the cost of originating, underwriting and servicing a small loan by half, according to a recent study by the Advisory Board Co., a Washington consulting group.

At branches around Albany, N.Y., for example, KeyCorp deploys a team of traveling small-business bankers with authority to approve loans from $25,000 to $250,000 on the spot. A small company whose paperwork is in order can get its money in three to four days, says Gerald N. Scalzetto, a vice president for Key Bank of New York. The typical U.S. bank takes seven to 10 days to process a small-business loan, the Advisory Board study says. Interest rates are usually somewhat higher on small-business loans than on other business loans.

KeyCorp's approach to small-business lending also puts entrepreneurial customers at ease. Owners of small businesses "have told us that they are much more comfortable dealing with their branch manager than dealing with a downtown lender," Ms. Maltby says.

KeyCorp is trying to reduce even more the time and cost of processing small loans. It recently opened four small-loan processing centers serving 10 states. It has also developed a program where business customers seeking standard loans fill out a streamlined application and get accepted or rejected that same day.

Of course, KeyCorp doesn't want to lend money only to small companies. It tries to turn borrowers into depositors and credit-card customers by billing itself as a "business partner" and offering brochures on business topics. In February, the company sponsored a small-business conference in Washington that featured speeches by lawmakers and lunches with top executives.

Few banking companies of KeyCorp's size pursue the small-loan market as aggressively. Norwest Corp., a Minneapolis banking company with more than $50 billion in domestic assets, reported small loans totaling $4.23 billion as of last June. That represented more than half its commercial loan portfolio. In June, almost 40% of commercial loans booked by Banc One Corp., an $85 billion banking company based in Columbus, Ohio, were for less than $1 million.

Still, KeyCorp anticipates fiercer competition for small-business borrowers among the nation's largest banks. "The small-business market is in vogue right now," Ms. Maltby says. Banks that had long ignored the small-loan market are trying to enter it, she says.

Jay Tejera, a banking analyst with Dain Bosworth in Seattle, says KeyCorp shouldn't worry much. With operations in such less-populated states as Alaska, Maine and Utah, "Key's competition is the local super-community bank, not the larger players that bring the same level of sophistication," he says.

Meanwhile, many small businesses prefer to deal with a lender of KeyCorp's reach. Frank Hoffman, president of F.L. Hoffman Corp. in Rensselaer, N.Y., says community banks aren't always savvy enough for his fast-growing construction-management firm. He says he recently sought help from KeyCorp's commercial side in arranging the complex financing of a new health-care facility.

Mr. Hoffman has a few complaints, though, about KeyCorp. He would like to see it lend to more start-ups. Dennis S. Buchan, a senior vice president with the New York unit, says the complaint is common. Banks traditionally have avoided lending to start-ups because they lack a track record.

Some observers worried that KeyCorp might outgrow its small-business focus when it merged with Society Corp. in 1993. But entrepreneurs say the combined banking company has retained its homey feel. A small-business owner and customer is even a director. Peter G. Ten Eyck of Indian Ladder Farms, an Altamont, N.Y., farm and retail market, joined the KeyCorp board before the merger.

And when KeyCorp's New York unit considered closing a Rensselaer branch earlier this year, it held a town meeting to gauge local reaction. More than 40 people attended to protest the move. The branch stayed open.

"It surprised me," says Richard C Carpinello, a local small-business owner. Given KeyCorp's size, "to actually hold a forum and listen to people, that was astounding."

TESTIMONY

BY

FRANK A. SUELLENTROP

Chairman
Community Bankers Association of Kansas
President/CEO
State Bank of Colwich, Colwich, Kansas

on behalf of

THE INDEPENDENT BANKERS ASSOCIATION OF AMERICA

before the

HOUSE COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

MAY 1, 1996

Madame Chair and Members of the Committee. The Independent Bankers Association of America (IBAA) appreciates this opportunity to present our views on the subject of "The Role of Banks in Small Business Financing.". My name is Frank Suellentrop. I am the chairman of the Community Bankers Association of Kansas, and President of the State Bank of Colwich, Kansas.

IBAA is the only trade association that exclusively represents the interests of about 5,500 independent community banks nationwide. Our Community Bankers Association of Kansas similarly represents 430 such banks statewide, including 14 in the Third Congressional District. We have talked with several Third District banks and their views reincorporated into this statement.

RECOGNITION OF OUTSTANDING COMMITTEE LEADERSHIP

At the outset, our associations wish to commend and thank the Chair for her outstanding work in behalf of small business.

We remember when Ms. Meyers was Ranking Minority Member, she conducted monthly breakfasts for small business associations, providing periodic contact with the Committee's agenda and its Members. This is a splendid example of how democracy ought to work.

After Ms. Meyers became chair of the Committee (the first woman chair of a Congressional Small Business Committee), the breakfasts continued, but a very energetic schedule of hearings and executive sessions was added. We understand that 59 public committee and subcommittee hearings were held in Washington, D.C. and in the field during 1995, more than one per week.

As a result, this Committee developed and guided to enactment legislation preserving and enhancing S.B.A.'s loan programs that are so important to small businesses.. Because of the real respect for the Small Business Committees, the major SBA financing programs were completely funded early this year. We also appreciate the Chair's support and testimony before the House Agriculture Committee for family estate tax relief for farms and small businesses, which IBAA believes is critical to preserving small communities a diversified and decentralized American economy.

PRIMARY ROLE OF COMMUNITY BANKS IN FINANCING SMALL BUSINESS

As noted in this Committee's February 28 introductory hearing on this subject, small firms are not identical, and many are, indeed, unique. There are individual proprietorships, partnerships, joint ventures, S-Corporations, and C-Corporations. There are start-up enterprises, on-going "life style" businesses and rapid-growth firms, both conventional and "high-tech."

Some owners have worked in their industries for decades and others are starting fresh, without much business experience or credit history. These varieties add up to a grand total of 22 million businesses in the U.S.A., about 12 million of which are full time.

This diversity is one of the great strengths of the American free enterprise system. Enterprises can adapt their form, structure and operations to the markets they have chosen and the shifting challenges of product development, market development, competition and overall economic conditions. Further, small firms can grow through several stages of development in a short time, as we are seeing right now in companies involved with the Internet.

The National Small Business United witness on February 28 , surveyed this diversity and observed that there is no single "silver bullet" that will slay the financing problems of all segments of the small business community. IBAA concurs, and believes these circumstances call for financial service providers and their associations, legislators and regulators to work together toward improving multiple avenues of access to capital.

As of February 1996, 3,460 companies were listed on the New York and American Stock Exchanges, and another 5,000 registered on NASDAQ. Perhaps 20,000 more firms are listed in the National Market System "Pink Sheets" as having stock that trades occasionally. Although the S.E.C. has liberalized small securities offering rules over the past 15 years, only a tiny fraction of the American business community -- just over 1/10 of 1 percent -- has access to any kind of public securities markets. This is understandable in the light of requirements of Wall Street --it takes somewhere in the neighborhood of $1 million in profits to support a national stock offering and about a half million dollars to support a regional offering.

So, that leaves banks generally, and community banks in particular, as the most important supplier of capital for the overwhelming number of small businesses. One indication of this role was a 1993 NFIB survey, which found that 37 percent of responding small firms obtained financing from banks, compared to 11 percent from finance companies, 8 percent from family and friends, 7.5 percent from leasing companies, and 6.2 percent in trade credit from other firms (Testimony of William J. Dennis, Jr., February 28, 1996 page 1). The 1993 Federal Reserve Study, that is discussed later in this statement, comes to a similar conclusion.

Although community banks occupy a niche in the small business financing universe, it is demonstrably the most important niche. But, banks are also subject to limitations. We are closely supervised by Federal and State agencies to assure that we maintain safe and sound institutions. We must constantly justify the insurance of depositors' funds by the Federal Deposit Insurance Corporation (FDIC). Banks are therefore subject to justifiable criticism by bank examiners if they make loans that really amount to equity capital, or that are not backed by collateral or other factors that "reasonably assure repayment." Regulatory scrutiny has been intense in the wake of the failures during the 1980s in both the Savings and Loan industry and the Farm Credit System.

The bulk of bank resources are short-term or demand deposits. It is therefore imprudent for community banks to make 5 or 7 year business loans at fixed rates and face the risk that market and interest rate conditions can shift against them during his period. Fortunately, certain government programs have made long-term loans possible -- under the Farm Credit System since 1916 and under the SBA since 1953. The February 28th testimony shows that the leading U.S. small business associations have a sophisticated understanding of these facts of bank life.

Among the "other" factors for assuring repayment are the banker's assessment of the borrower's character, and his or her family history. The average community bank member of IBAA was founded in 1920. With deep roots in their cities and towns, community bankers are able and willing to make such judgements. Branch managers for chain banks often do not have the experience to make such assessment . If the risk is greater, the community banker may charge a little more for loan. But, community banks are more willing to consider character as part of their lending decision. N.F.I.B.'s Feb. 28 testimony confirms that availability of credit is the most important factor to any small business; the price of the credit is secondary.

The statistics presented in this statement bear out that commercial banks, and especially small local community banks, are the primary financial source of small businesses and family farms. Community banks loan a far greater percentage of their money to small businesses than do larger banks. In fact, community banks account for about half of all small business lending, despite their modest percentage of deposits and other resources. Community banks tend also to be the primary financial advisors of small businesses. This partnership has proved its worth for small business, for job generation, and the U.S. economy.

However, just when community banks are needed most, their numbers appear to be declining while the numbers in all the larger size categories is growing. Banking is becoming more concentrated at a time when IBAA believes the U.S. financial system should be striving to become more decentralized, diverse and flexible. So, these hearings serve an excellent purpose in focusing on how this partnership of community banks and small and family businesses can be sustained and improved.

Independent bankers believe this can be done by working toward a level playing field for all credit providers, so there is greater and fairer competition among multiple sources of capital to render services to the small business community.

IMPORTANCE OF NEW AND SMALL BUSINESS TO THE U.S. ECONOMY

The Chair's February 28th Opening Statement noted that small business accounts for the majority of U.S. sales and employment.

The ability of our economy to generate private sector jobs reduces federal expenditures for unemployment, welfare, and related consequences. Minimizing unemployment makes the overall economy more efficient. The higher the quality of the jobs available, the higher the quality of individual and national life.

According to both public and private sources (SBA, White House Conference Issues Handbook, 1994, page 12; David Birch, 1979; NFIB Foundation, 1993) small business has accounted for 2/3 of the net new jobs in the U.S. economy since the early 1970s.

In contrast, large U.S. corporations are downsizing. The annual Fortune Magazine survey indicates that U.S. employment at the 500 largest companies has declined from a 1979 peak of 16

million to 11.5 million in 1993. Management experts, have noted that downsizing "has become a systematic, on-going corporate activity" as companies seek to realize savings from labor-saving technologies and business combinations (See, for example,"Large U.S. Companies Continue Downsizing," Washington Post, Sept. 27/94, page C1).

The New York Times recently ran a series of articles on the "Downsizing of America," in which it is estimated that about 43 million jobs have been eliminated since 1979 ("On the Battlefield of Business, Millions of Casualties," March 3, 1996, page A1).

However, despite the downsizing and turnover from business failures and terminations, jobs in the U.S. economy, since 1980, increased from 80 million to 125 million, a net increase of approximately 45 million new jobs. The European Community, which has a larger population, has created less than 10 million new jobs during this period ("Labor Force, Employment and Earnings, Statistical Abstract of the U.S., 1990, page 378; "The Useless Jobs Summit," by R. Samuelson, Washington Post, March 4, 1994). This is a remarkable success story.

New and small businesses are the major part of this story. According to IRS figures on tax return filings, the overall number of U.S. businesses increased over the past 15 years from 13.8 million to 22 million ("Statistics of Income," Internal Revenue Service, 50th Anniversary Issue, 1994, page 46 and 1996 update by IRS).

NON-FARM BUSINESS TAX RETURNS (Numbers in thousands)

	C-Corps	S-Corps	Partnerships	Proprietorships	Total
1994					22,000
1990	2,142	1,575	1,759	14,241	20,653
1980	2,165	545	1,380	9,730	13,820

As noted above, about 12 million of these enterprise provide full time employment to the owner. Approximately 5 million of these firms provide jobs to other employees ("Small Business Primer," NFIB, 1993, page 2).

A central element of U.S. economic strength is the "growth band" of the economy. According to a leading authority, this sector is composed of about 50,000 start-ups per year and approximately 500,000 firms growing in excess of 20 percent per year. It accounts for the lion's share of both employment growth and innovation (Statement of William Wetzel, Jr., Center for Venture Research, University of New Hampshire, to the SEC Forum on Small Business Capital Formation, September 8, 1994, page 3). These firms tend go through the classic small business growth cycle.

Many studies by the National Science Foundation have confirmed that small enterprises produce half of all U.S. industrial innovation. So, the small business dynamics are vitally important for American jobs and prosperity.

For example, start-up U.S. companies since World War II have created whole new industries, such as computers, microchips, software, and biotechnology that are on the leading edge of world manufacturing and services. Venture capital firms have played an important catalyzing role with such pace-setting companies as: Digital Equipment, Apple and Compaq Computer, Sun Microsystems, Federal Express, Intel, Cyprus, Microsoft and Lotus. These companies and industries have taken the U.S. economy to the #1 ranking in international competitiveness for both 1994 and 1995, according to the World Economic Forum.

Such successes are reflected in increased U. S. exports of goods and services. The National Association of Manufacturers told this committee that the U.S. share of manufactured goods in global markets climbed from 11.6 percent a decade ago to 12.9 percent now (Statement of M. A. Gerber, Feb. 28, 1996). Overall, U.S. exports more than doubled from 1984 to 1995, from $219.9 billion to $574.9 billion (Economic Indicators, Council of Economic Advisors/Joint Economic Committee, February, 1996, page 36).

IMPORTANCE OF SMALL BANKS TO NEW AND SMALL BUSINESS

The core business of community banks is servicing the financial needs of their communities, including consumers, small businesses and farms. Community banks are locally owned and operated and independent of any statewide, regional, or super-regional group of financial institutions. Their boards of directors are composed of local citizens who have a natural interest in building up the towns and cities where they live and where their banks do business.

Most community banks themselves are small business. The median IBAA member bank holds about $47 million in assets and has about 24 employees. My own bank is very close to the median, with about $65 million in assets. Over the past six years, our bank has made 27 SBA guaranteed loans totaling $5 million. Based upon 288 commercial loans outstanding as of March 31, 1996, for every SBA loan, our bank has made about 20 conventional small business loans. SBA guarantees helped us make the larger and longer term loans.

Federal statistics provide "proof positive" that community banks focus on, and specialize in, small business lending. During 1994 and 1995, banks of less than $100 million in assets (holding about 7 percent of U.S. deposits) loaned about 28 percent of all the dollars lent by banks in amounts of less than $100,000. Loans of this size are the heartland of small business lending, being 2 ½ times more frequent than loans of $100,000 to $250,000.

Many banks with $100 million to $300 million in assets are also locally owned. Collectively, banks with less than $300 million in assets (holding a total of 15.3 percent of U.S. deposits) loaned approximately half of all the dollars in amounts of less than $100,000 and almost half of the dollars in amounts less than $250,000 lent by banks in 1994 and 1995.

Similarly, what IBAA would classify as medium-sized banks -- with up to $1 billion in assets -- account for 73 percent of the loans of less than $1 million ("Small Borrowers and the Survival of the Small Bank," L.I. Nakagama, Business Review of the Federal Reserve Bank of Philadelphia, Nov.-Dec. 1994, page 11).

The landmark 1993 Federal Reserve survey of 5,300 firms found that local community banks are the primary financial advisors of small enterprises ("Financial Services Used by Small Businesses," Federal Reserve Bulletin, July, 1995, page 629). Community banks have an incentive to spend time rendering such advice; they are on Main Street for the long haul. They have both a financial and a neighbor's interest in seeing businesses succeed and, grow.

Community banks have no lack of competition. Non-banks are prominent among them. The Money Store, which advertises small business loan services nationally, has been the largest single generator of SBA loans for the past 15 years (Coleman Report, March 15/95, page 3). A 1996 survey by the Consumer Bankers Association found that 28 percent of the banks responding rated the brokerage firm of Merrill Lynch as their third-biggest threat ("Banks Look to Automation to Hold Off Non-Bank Rivals," American Banker, April 8/96).

Some mid-size and large banks are targeting the smaller business loans market ("Big Banks Target Small Business for Loan Growth, Survey Says," American Banker, March 9/94). Increasingly, these larger institutions are utilizing sophisticated techniques of credit scoring and data base management to market their services to small firms, in some cases pre-approving credit limits for small businesses as has previously been common with individual credit card solicitations.

However, many larger banks maintain minimum loan limits that exclude or discourage small enterprises. Many others seem to feel that added costs of small credits diminish their overall profitability in today's intensely competitive world of regional banking. Richard Thomas, of First Chicago Corporation, told the House Government Operations Committee a few years ago that:

> "In a large bank it would be difficult to make money on a loan of less than half a million dollars. I suspect the number might be $25,000 for a much smaller bank with a much smaller overhead."

There is some evidence that when banks with small business loan portfolios have been acquired, small loans have been allowed to run off ("Banks and the availability of small business loans," Peak and Rosengren, Working Paper 95-1, Federal Reserve Bank of Boston, January/95). A study by the Federal Reserve Bank of Kansas City found that smaller banks owned by multibank holding companies and banks owned by out-of-state financial institutions "tend to lend a smaller share of their funds to small firms than in-state, independent banks do" ("Big Banks Lend More to Small Business, But Some Fear Gains May Be Short Lived," Wall Street Journal, Dec. 28/95). Another recent study of 180 banks, divided between acquired and non-acquired institutions (by the NY FED), found that, in the 1993-95 period, small business lending declined more slowly in the acquired banks (.2%) than in the non-acquired banks (.5%) ("Small-business loan numbers unaffected by bank mergers, study shows," Columbus Dispatch, Feb. 27, 1996).

IBAA urges that continuing quality research be done on service to small businesses and farms by acquired and acquiring banks. We feel that Congress and federal executive and supervisory agencies -- including SBA -- should chart these vital economic consequences of changing bank structure as a guide for future policy decisions by Federal and State governments and the private banking industry.

HOW COMMUNITY BANKS HELP SMALL FIRMS ACCESS CAPITAL

This performance record by independent banks in behalf of small business borrowers does not come easy. A study by the Federal Reserve Bank of Atlanta points out that the costs of making, monitoring and collecting on small business loans are higher. But, even in the face of higher expenses, locally owned banks make a go of it because on-going relationships cut down risk and the local banks are able to monitor unsecured credits from these continuing contacts.

The 1995 Federal Reserve Study finds that community banks help new and small businesses at a very early stage. The data reveal that the newest and smallest firms are using bank-provided financial services at nearly the same rates as older and larger firms. Ninety percent of the firms with no employees or one employee have checking accounts; many use depository services: sixteen percent have lines of credit; seventeen percent have vehicle loans and an additional four percent have capital leases. In addition, the smallest firms are likely to utilize bank financial management advice, employee benefit plans and other bank services.. The study found that firms in existence less than 5 years had nearly the same incidence of borrowing (about 60 percent) as older and more mature businesses ("Financial Services Used by Small Businesses: Evidence from the 1993 National Survey of Small Business Finances," Federal Reserve Bulletin, July 1995, pages 634 and tables A2A and A2B, pages 646 and 648).

Community banks are thus a resource for small business capital access that are well worth preserving.

THE DECLINING BANK POPULATION

The past 15 years has seen consolidation in the banking industry that is unparalleled since the Great Depression. ("Banking Industry Consolidation: Past Changes and Implications," by Daniel Nolle, U.S. Comptroller of the Currency, Working Paper 95-1, April, 1995). For example, from 1986 to the end of 1995, the number of U.S. banking companies declined from 14,046 to 9,941, down 29.22 percent. The total number of banks dipped below 10,000 for the first time in 60 years ("93 Buyouts Thinned the Ranks of Small Banks to 60-year low," American Banker, March 21, 1994)..

A comparable decline took place in Kansas during the past decade, from 612 to 430 banks, or 29.74 percent.

The bad news for small business in these figures is two-fold. First, according to the OCC, all of the net losses took place in banks of less than $100 million in assets. The number of banks in every other size category increased (Nolle, loc. cit., page 8).

The number of de novo bank charters, which has be publicized recently, totals about 400 in the past 5 years, offsetting approximately 10 percent of this decline of 4,000 in the number of community banks (see "Displaced by Mergers, Some Bankers Launch Their Own Start Ups," Wall Street Journal, March 4, 1996, right lead).

Second, the largest banks have steadily increased their share of industry assets and deposits over the past decade. The top 100 bank holding companies increased their share of industry assets from 44 percent in 1985 to 62 percent at the end of 1995, and their share of U.S. deposits from 38.5 percent to 56 percent during the same period ("Top 100 Banks Tighten Grip on Industry," American Banker, March 28, 1996). This article concluded that: "The steady expansion of big banks over the last decade (has) strengthen(ed) their already predominant position in the industry."

The good news is that the surviving banks -- of all sizes -- earned good profitability for the past four years, and are ready, willing and able to make loans. In 1995, the amount of commercial and industrial loans grew by a record amount of $244.5 billion (10.4 percent), surpassing the previous (1994) annual increase of $208.4 billion ("FDIC Reports Record Earnings for Commercial Banks in 1995" PR 19-96, March 14, 1996).

FINANCIAL CONCENTRATION TO DETRIMENT OF SMALL BUSINESS

Responding in large part to this public policy decision by the 103rd Congress to permit full nationwide banking and interstate branching by 1997, the banking industry in the past 15 months has experienced , branch closings and job losses. (See: "Merger Mania Momentum Multiplies," U.S.A. TODAY, March 6, 1996, page 3B). The financial institutions industry is in the forefront of the merger movement. Last year, there were 330 bank combinations, accounting for more than 20 of the overall merger dollar volume, including 4 out the 10 largest mergers of 1995 ("Banks Top This Year's List of Mergers," Washington Times, January 2, 1996; "1995, The Year of the Merger," Washington Post).

Both the Chase-Chemical and the Bank of America-Security Pacific mergers will reportedly eliminate more than 10,000 jobs.

As a result of the merger movement, the Mid-Atlantic region has already lost one out every five financial institutions since 1988 ("Bank mergers take toll on smaller businesses," Washington Business Journal, Oct. 27-Nov. 2, 1995). The reporter's conclusion: "Choice is a shrinking commodity in Washington's financial arena."

The testimony before this committee is that, in concentrated banking markets like Connecticut, interest rates and fees charged to small businesses and consumers are higher and terms for capital access are more stringent (See Statement of NAM, Feb. 28/96).

IBAA has pointed out to the House Banking Committee that, in California, where four banks control 60 percent of deposits, a 1992 study found that loan rates were significantly higher

and deposit yields lower than the national averages (Testimony of IBAA before the Subcommittee on Financial Institutions, House Banking Committee, October 17, 1995).

An recent article in U.S.A. TODAY noted that in Florida, where four banks control 70 percent of bank deposits: "Fees are higher than in most states. Savings interest rates are lower. Loan rates are higher." Examples included: CD rates averaging 5.2 percent vs. 5.6 percent nationally, 30-year fixed rate mortgages at 8 percent vs. 7.82 percent nationally, and unsecured personal loans averaging 16.3 percent in Florida vs. 15.9 percent nationally. The article also predicted that, by 1998, 300 large banks will control 85 percent of the nation's banking deposits, and that 2,000 banks will disappear (Sept. 1, 1995).

Community banks believe these examples demonstrate that financial concentration results in less competition and higher prices for services, and is not good for small business, the consumer, smaller communities or the American economy.

Unfortunately, Madam Chair, legislation is pending before the House Banking Committee that would open the door to common ownership of the largest commercial banks, securities firms, and insurance underwriters. The massive financial concentration that would result is of major concern to the small business community and American agriculture. It is with regret that we oppose the financial consolidation package Chairman Leach is putting together -- a package that would benefit Wall Street to the detriment of Main Street.

Under current conditions, concerns are rising now that bank managements are located ever more distant from Main Street businesses, and loan officers have a high turnover ratio in branch locations. There is a legitimate question of whether banks structured in this way have the incentives for appropriately considering the financial needs of local small businesses and farms.

These considerations are illustrated by a recent article headlined: "Merger Mania Leaves Charities in Many Cities Scrambling" American Banker, August 1, 1995). The President of $700 million asset Southwest Bank of Houston was quoted as saying: "The out-of -state banks just don't participate (in civic projects). The banks no longer have their head offices here. Nobody feels permanent. They never develop that community spirit . . .It's sad, really." Declines in support for the United Way, the arts, and various charities were reported from other "branch office towns" such as San Diego, Indianapolis, Baltimore and Columbia, South Carolina.

This article recalls the 1946 report to the Senate Small Business Committee by the Smaller War Plants Corporation. The report found that in cities characterized by smaller businesses, spending on education, libraries and hospitals, charitable donations and church membership tended to be higher. The report attributed these consequences to the community spirit of owners of local businesses (see "Small Business and the Quality of American Life," Senate Small Business Committee, Nov. 7, 1977, page 540).

THE ROLE OF VENTURE CAPITAL

Filling out the picture of sources of small business capital are venture capital firms. Their role is relevant to this inquiry because banks and venture capital providers serve very different small business marketplaces.

At the base of the venture capital pyramid, New England's William Wetzel estimates that high net-worth individuals, known in the small business world as "Angels," informally invest about $10 billion a year in local small firms with which they are familiar.

Most visible to the public are the 200 or so professional private sector venture partnerships, which are financed entirely with private funds. As we have seen, these firms have had a great impact on the U.S. economy through their ability to finance, counsel and otherwise assist high-tech startups. Typically, venture partnerships would invest about $10-20 million per firm, in the form of multiple financings, in enterprises that envision a market potential of $50 to $100 million. Collectively, venture firms invest between $2-4 billion annually (about one days worth of volume on the New York Stock Exchange), in about 1,000 firms.

Small Business Investment Companies and Specialized SBICs -- which receive some assistance from the SBA -- also make these types of investments, but from a smaller foundation and in smaller amounts. There are currently 185 active SBICs and 89 Specialized SBICs that deploy $3.7 billion of their own capital and $1.02 billion in SBA guaranteed leverage (Testimony of Patricia Forbes, SBA Acting Associate Deputy Administrator for Economic Development, Senate Small Business Committee, Dec. 12, 1995, page 3). SBICs invest about $1 billion a year in about 1,000 firms, with investments in individual firms of somewhat less than $1 million.

So, formal and informal venture capital firms are valuable assets -- addressing several financing gaps for smaller growth-oriented companies that need good advice and long-term debt and equity financing. But, venture capital firms have their specialties. They do not come close to servicing the general financing needs of the multifaceted small business community.

ENCOURAGING THE FLOW OF CAPITAL TO SMALL FIRMS

New and small firms subsist and grow on capital. An effort to encourage new and small business, and thus, economic growth, employment, quality jobs, and internationally competitive firms, should logically focus attention on the institutions providing financing to these enterprises. The strength of our free enterprise system is competition, and the ability to innovate to meet the changing needs of customers.

PRESERVING THE ENVIRONMENT FOR COMMUNITY BANKS

The independent community banks in this country welcome competition, as long as it is on a level playing field, which it now is not.

Regulatory relief legislation should be enacted. As this historic Congress heads for its

home stretch, it could take one action that would go a long way toward preserving an environment viability for community banks. We urge this Congress to keep its promise and accord community banking relief from a crushing regulatory burden. A meaningful regulatory relief b ill (H.R. 1858) is pending before the House Leadership, and, unfortunately, is being held hostage to a broader financial restructuring bill that is not consistent with the interestss of the nation's small business community.

The accounting firm of Grant Thornton surveyed 2,600 community banks and found that the cost of compliance with the dozen most pervasive federal regulations was $3.2 billion per year, an enormous sum of money, that could be devoted to financing small business. One-third of this total, over $1 billion, was attributable to the Community Reinvestment Act (see "Regulatory Burden, the Cost to Community Banks," Jan., 1993). These kinds of burdens are breaking the backs of community banks, and making it much more difficult to serve the credit needs of their communities.

Regulatory relief is the number one priority of community banks this year. Such a bill should be passed by this 104th Congress.

Equality of treatment. Certain legislative and regulatory changes could make competition fairer and help preserve community banks as the financing partners of small business. Other significant participants in the financial system, such larger regional and national banks, non-bank lenders, credit unions, mortgage bankers, and finance companies are free of either tax or regulatory burdens borne by smaller commercial banks -- and sometimes both.

Longer-term, we strongly urge that the Congress review the privileged status of credit unions. Larger credit unions, which are virtually indistinguishable from commercial banks, are exempt from federal and state taxation and are exempt from many federal regulatory requirements, including the Community Reinvestment Act. They also receive services like office space, utilities and security free or at reduced costs from their sponsors, which are often government agencies. Credit unions can arrange to get preferred access to customers via direct deposit of paychecks of their sponsoring organizations. Many credit unions advertise their services to the general public. Bankers feel strongly that credit union tax and regulatory exemptions, which were born of the Great Depression, are now obsolete.

Credit union, with these preferences, absorb significant deposits from the commercial banking system, where they would otherwise be available to make loans to family farms and small businesses. Commercial loans were never contemplated as a part of the Federal Credit Union Act of 1934, the basic credit union charter.

Non-bank lenders are not subject to bank-like supervision. They enjoy privileges with respect to SBA lending that commercial banks do not. They can sell both guaranteed and the unguaranteed portion of SBA-guaranteed loans into the secondary market, which commercial banks cannot. Community banks feel this inequality is both an unfair competitive advantage and bad policy.

Bank holdings of financial assets have declined steadily from 42 percent of the total in 1950 to 22 percent in 1996 ("Assessing the Competitive Landscape," Journal of Lending and Credit Risk Management, January 1996, page 12). As competition becomes ever more stringent, community banks will find it more difficult to survive such competitive disadvantages imposed by law and regulation.

Consideration of pending banking structure legislation. If Glass-Steagall Act restrictions on the common ownership of banks and securities firms are relaxed -- and especially if the door is opened to common ownership of banks, brokers and insurance companies -- there will be mammoth financial inducements to mergers and acquisitions and greater financial concentration will follow.

Antitrust standards have a continuing function. At a minimum, the Bank Merger Act and other antitrust statutes should continue to be applied as bank consolidation and financial services integration gathers increasing momentum, to assure that small businesses and family farms lending services are maintained in the era of mega-mergers (See: "Nonbanks Gain in Small Business; Bank Merger Scrutiny Excessive?" American Banker, Sept. 26/95). IBAA was pleased that Federal Reserve Chairman Alan Greenspan noted in his recent re-confirmation hearing that the FED would continue to monitor credit available to small businesses as the rapid pace of bank mergers continues ("Greenspan Defends The Fed on Spending, Confirmation Vote Set," American Banker, March 27, 1996).

GOVERNMENT ENHANCEMENT OF CREDIT

Government programs of guaranteeing credit are important to small businesses, independent banks and their communities. They make possible loans that would otherwise be unbankable.

Home Loan Bank legislation. Another significant Congressional action would be passage of legislation introduced by Congressman Baker to reform the Federal Home Loan Bank System. Community banks in rural America are beginning to encounter liquidity problems as core deposits flow to mutual funds. As we well know, mutual funds do not make business loans. Chairman Baker's proposal would make advances from Federal Home Loan Banks more readily available to banks lending to small businesses and agriculture. IBAA is also pushing to allow community banks to tap the funding source of the Farm Credit System, which enjoys GSE status.

SBA and related guranatee programs On September 30/94, 7,364 lenders held SBA loans. According to the General Accounting Office, about 60 percent of all long-term fixed-rate business credits are supported by SBA guarantees. These loans have an average maturity of about 7 years, a term beyond the capacity of most community banks. The increase of the SBA section 7(a) program from $7.8 billion in 1993 and 1994 to $10.8 billion in 1995 to an estimated $11 billion in 1996 (all fiscal years), means more authentic small business lending is taking place.

Export financing programs of the SBA and the Export-Import Bank also provide long-term fixed-rate financing for small U.S. firms wishing to do business abroad. These programs seek to assure that American firms do not lose sales because of the aggressive government-supported financing programs of competitor nations.

Enhancing small business markets. We feel that intelligent engagement with international financial institutions is profitable for U.S. small businesses in general and small business in particular. In 1995 the U.S. shipped $50.5 billion in agricultural exports (Economic Indicators, February, 1996, page 35). Loans from community banks financed some of this production. From 1981 to 1993, some 75 countries received assistance from the World Bank, conditioned upon opening up their trade and investment policies. According to the Treasury Department, U.S. exports to these countries rose an average of almost 12 percent yearly, a rate which would double American exports to these countries every 6 years (Remarks of Jeffrey Shafer, Under Secretary of the Treasury for International Affairs, Bankers Association for Foreign Trade, January 18, 1996).

Secondary markets activities. Securitization is coming to the business loan marketplace, and experts have already concerns that the securitization process will reduce the role of community banks in financing small firms ("The Weakening Role of Banks in Financing Small Business," Association of Reserve City Bankers, June 1993). We share those concerns.

IBAA is well aware that secondary markets for housing loans eroded the position of the thrift industry. Even though many small business loans are individualized, and cannot be "cookie cutter" credits, the best credits could be skimmed off by a secondary market to the detriment of community banking. Care needs to be taken to have existing community bank experience reflected in the underwriting standards and other terms and conditions of this new marketplace. Also, IBAA continues to oppose strongly any legislative proposal to create a new Government Sponsored Enterprise for securitization purposes..

State and local and community development lending and counseling programs make considerable contributions to screening and funding small enterprises with promise. They are often partners with small firms and commercial banks in putting together SBA section 504 loans.

THE ROLE OF VENTURE CAPITAL

As noted above, venture capital programs and processes -- both formal and informal -- play a vital role in providing risk capital for new and small business and thus need to be nurtured. The MIT program of matching local investors with local companies seems to have potential for application elsewhere, especially in areas of the country that do not have many formal venture firms or SBICs. This model should be replicated across the country. As noted below, capital gain tax rates and holding periods have a critical effect on the willingness of private investors to provide "patient capital" for economic development. Community banks are in the process of exploring how banks can cooperate with SBICs to provide improved access to the various types of capital and financial services needed by rapid-growth firms.

THE ROLE OF TAXES IN SMALL BUSINESS CAPITAL ACCESS

The testimony of the Small Business Legislative Council (SBLC) and other witnesses on February 28th highlights how important the tax incentives and disincentives of the Internal Revenue Code are to small business activity -- which is primarily incentive driven.

Community bankers fought hard during this Congress for the tax program of the House and Senate leadership, testifying before six House and Senate Committees in 1995 -- including this one -- in support. Our agenda, which is largely small-business oriented, includes:

estate tax relief for family owned businesses and farms, to help keep business ownership in the family and in small communities (The Dole-Pryor and McCrery-Dunn-Brewster bills: S.1086 and H.R. 2190),
enhancement of the Individual Retirement Account, to encourage long-term saving (The Roth and Thomas-Neal bills: S. 12 and H.R.652),
capital gains reduction, in a way that helps small business and encourages "patient capital" for economic development,
increasing the amount of small business expensing,
permitting conversion of bank trust funds into a family of mutual funds, for the benefit of the trust beneficiaries, and

some Alternative Minimum Tax relief, that is scaled to the size of community banks and their customers.

We were gratified when these provisions passed the Congress as part of the Balanced Budget Act of 1995. We also advocated retention of the current rules on loans to Employee Stock Ownership programs, to allow employees to build up a stake in their employers. As previously noted, we feel the tax exemption for larger, bank-like credit union should be repealed.

We believe these tax changes would contribute materially to small business capital access and capital formation, as well as national economic growth and stability.

CREDIT FOR WOMEN, MINORITY AND OTHER ENTREPRENEURS

The trends seem clear that there will be more women, minorities, and senior citizens in the general population and in the ranks of small business owners.

The record of almost 15 years confirms this. The Census Bureau found that, between 1982 and 1987, the number of women-owned firms increased by 57.4 percent (4 times the rate of businesses as a whole). The number of women-owned firms with employees grew 98 percent during that period (Workshop Report, "Access to Equity Capital Expert Policy Workshop," National Womens' Business Council, June 3, 1994, page 25). From 1987 to 1992, the number of women-owned firms increased another 43 percent (Wall Street Journal, January 29, 1996).

The Census Bureau further counted approximately 6.4 million women-owned businesses in 1992, about one-third (33.2 percent) of all U.S. businesses. The National Foundation of Women Business Owners projects that, by 1996, there were 7.9 million women-owned firms, and employing more paid workers than the Fortune 500 ("Women Business Owners Economic Impact Re-Affirmed," National Foundation of Women Business Owners, Press Release, March 27, 1996). SBA reported that its volume of lending to women-owned firms increased 84 percent from FY 1994 to FY 1995. The FY 95 dollar value was $1.44 billion, about 24 percent of the Agency's total.

Minority-owned business also shows growth . In 1987, there were 1.2 million minority-owned firms, up 67 percent from 1982 ("1987 Survey of Minority-Owned Businesses," U.S. Census Bureau, MB87-4, released August, 1991). Minority-owned firms, at that time, accounted for 9 percent of the number of U.S. firms, 4 percent of gross receipts ($78 billion) and about 800,000 paid employees. Minority ownership is defined to include Blacks, Hispanics, Asian-Americans, American Indians and certain other categories. SBA reports that minority-owned firms received $1.6 billion in loans in FY 1995, a 53 percent increase over FY 1994, and about 19 percent of SBA's loans.

By geographic area, minority-owned firms represented more than half of the business population in Hawaii (53.7 percent), a third in the District of Columbia (33.4 percent), a fifth in New Mexico (20.6 percent), 17.9 percent in California, 14.9 percent in Texas, 12-13 percent in Florida and Alaska, 10.7 in New York State and 10.1 percent in Louisiana.

If the past is prologue, community banks will become increasing involved with such lending. The Census Bureau's "Middle Projection" has also predicted this kind of future, concluding that the U.S. population will increase 23 percent by the year 2020, to 322.6 million, but with the following variations in that growth:

- While the non-Hispanic Caucasian group will grow by 6.4 percent, the nation's "minority" population will soar by 68 percent during that period, or 10 times as fast. So, by 2020 more than 1 of 3 Americans will have a minority heritage, compared to 1 of 4 now.
- The number of people under the age of 18 will rise 11 percent, but the number aged 45 to 64 will increase 54 percent and the number over age 65 will climb about 60 percent.
- Three states--Florida, California, and Texas probably will continue attracting half the nation's population growth, though other Southeastern and Southwestern states will also grow rapidly (see: "Demographer With 2020 Vision Sees America's Infrastructure Needs," Anthony Downs, Senior Fellow, Brookings Institution, Washington Post, March 23, 1994).

So, community banks, with their specialized financing skills, will be needed to provide the

combination of credit and advice to give new small businesses their best chance for success.

SMALL BUSINESS CREDIT NEEDS SHOULD RECEIVE CONTINUING ATTENTION

The changes in markets, policy and technology we have identified would also suggest continuing consideration to these issues. Moreover,. Small business should be represented in government federal and state decision-making as developments unfold in such vital areas as implementation of the Interstate Banking and Branching Act, the possible effects of modifying the Glass-Steagall Act, the impact of new technology, the statewide and national expansion of credit unions, and the transfer of bank deposits to mutual funds (See: "Mutual Funds, Impact on Bank Deposits and Credit Availability," General Accounting Office, GAO/GGD-95-230, Sept./95).

We thus favor revisiting this type of inquiry periodically. Meanwhile, research on these matters should continue -- both on Capitol Hill and in the Executive Agencies.. Such on-going efforts could be valuable sources of data for public policy decisions on U.S. financial structure and its ability to provide capital to the vital small business sector of our economy.

Thank you again for this opportunity to express the views of community bankers on this important subject.

Statement by

Janet L. Yellen

Member, Board of Governors of the Federal Reserve System

Before the

Committee on Small Business

of the

U.S. House of Representatives

May 1, 1996

Introductory comments

I am pleased to be here today to discuss the environment for small business financing and the role of banks in providing credit to small firms.

Small businesses are a vital part of our economy. They play a key role in the generation of jobs, new ideas, and the preservation of the entrepreneurial spirit; no one would question the contribution that a thriving small business sector makes to the well-being of our nation. It is therefore appropriate that small businesses hold a special place in the considerations of policy makers at all levels of government.

The Federal Reserve Board has devoted considerable effort to building our knowledge of the characteristics of small businesses and their use of financial services. As the Committee is aware, we have recently completed our second National Survey of Small Business Finances; Board staff are now processing the results of extensive interviews with more than 5,000 small business owners around the country. Some of the early findings from the survey were published in the July 1995 Federal Reserve Bulletin, and we will continue to analyze and report on the data as they become available. I will refer to this and other survey information in my remarks this morning.

Credit Availability Today

As I developed my thoughts for this hearing, I came to appreciate how much more pleasant it is to report on conditions in good times than in bad times. When Chairman Greenspan appeared before this committee in early 1993, a tepid recovery from recession was beginning to give way to

more solid expansion. But commercial banks were still struggling with severe loan problems that resulted from excessive optimism in real estate and certain other loan markets in the 1980s. Because of large loan losses, many depository institutions had failed or been merged. Although there were signs in 1993 that banks were on the mend, credit conditions generally remained quite tight. The sting of the "the credit crunch" was still a fresh memory in the minds of borrowers and lenders, not to mention policy makers.

Out of concern that exaggerated lending restraint might have been fostered by regulatory and legislative reactions to the numerous problems in the industry, the regulatory agencies undertook an extensive review of their policies and practices. This review produced a number of measures aimed at removing impediments that might stand in the way of lending to creditworthy borrowers. Former Federal Reserve Governor John LaWare, in testimony two years ago, highlighted for this Committee many of these changes.

Since then, the agencies have continued their efforts to reduce the burden of regulation and to ensure that examiners evaluate bank lending in a consistent, prudent and balanced manner.

I think we would all agree that the financial environment today is markedly improved from that of 1993. While undoubtedly there remain pockets of weakness and problems for individual small businesses, a wide array of statistical indicators suggest that access to bank credit has eased appreciably for all businesses. Business loans at banks have expanded rapidly since 1993. Indeed, the volume of commercial and industrial loans at banks grew strongly in 1994 and then last year registered its largest percentage increase in more than a decade (13 percent).

Small businesses have participated in this expansion. Data collected from banks in their June Call Reports reveal that small commercial loans (defined as loans of $1 million or less and including those secured by commercial real estate) increased more than 7 percent between June 1994 and June 1995. Roughly one-third of the growth in small loans over that period occurred at 7,000 mostly small and regional banks whose business loan portfolios comprise only small loans.

A good portion of the expansion, however, was at large banks (those with assets of $5 billion or more). Part of the growth at large banks reflected the effect of bank mergers that moved more banking assets into the largest size categories. Nonetheless, even after adjusting for these transactions, large institutions expanded their lending to small firms an estimated 4 percent. We sometimes forget that large banks account for an important share of loans to small businesses, even though such loans may only be a small fraction of a large institution's total assets.

The pickup in business loan growth has been, in important part, a demand-related phenomenon. As the economy has grown, business needs for financing have expanded as well.

But the willingness of banks to supply credit also has been on the upswing. Continued improvements in bank profits, healthy capital positions, and low delinquency rates on business loans have encouraged banks to compete aggressively for business customers. The Federal Reserve conducts quarterly surveys of senior loan officers at sixty large banks around the country. For ten consecutive quarters since mid-1993 until the end of last year, these banks, on net, reported easing the terms and standards

applied to business loans for all sizes of borrowers. Respondent banks last year attributed their easing primarily to increased competition from other banks and, to a lesser extent, from nonbank lenders. This easing has shown up in surveys of lending terms: for example, the spread between rates on business loans and market interest rates fell last year for loans of all sizes.

Perhaps the most telling evidence of improved financing opportunities are reports from small businesses themselves. Small and mid-sized firms surveyed by the National Federation of Independent Businesses (NFIB) had reported that "interest rates and financing" were among their most pressing problems in the early 1990s. However, only a small percentage of firms cited this as a concern in recent surveys. In addition, the net percentage of NFIB respondents reporting that credit was more difficult to obtain dropped appreciably from peaks in 1990 and 1991 and has fluctuated around low levels over the past year. The NFIB surveys have been consistent with reports heard at the Federal Reserve. For example, the Federal Reserve District Banks meet periodically with representatives from the small business and agricultural sectors; representatives at these meetings generally have been quite positive with regard to credit availability.

It would appear from our latest quarterly surveys of banks that the trend toward easing standards for business loans has come to an end, but there is no sign of reversal, and banks, on balance, remain accommodative to business credit demands. Given prospects for moderate growth in economic activity and the healthy position of banks, the outlook for bank lending to small businesses continues to be favorable.

While we are pleased with the improvements in credit availability, it would be foolish to assume that no problem areas exist or that small businesses are no longer vulnerable to changes in the financial environment. The small business community is diverse. Many are quite small without the operating history or assets that make them good credit risks. Start-up businesses may have high growth potential but little equity. Because most small businesses have no access to public debt markets and equity markets, they are likely to be especially sensitive to developments that affect institutional lenders and local credit markets.

As we consider the potential problems that small businesses may face down the road, we would like to know more about their sources of credit. Our survey of small businesses provides some useful insights in this regard.

Sources of Small Business Credit: Survey Evidence

In our 1993 survey, 84 percent of small and medium-sized businesses identified a commercial bank as their primary financial institution. Banks were used more often than any other type of supplier. Most small firms used checking services at banks, and commercial banks are used twice as often as any other source for lines of credit, loans or leases.

Most small businesses used a commercial bank located close to the firm--indeed, about 85 percent of all suppliers of financial services to small businesses were located within 30 miles and about half of the depository institutions were within two miles.

About one-third of small firms also used nondepository institutions for financial services, and twenty percent had some loan from a nondepository source. The most common loans from these sources are vehicle loans and capital leases. Such loans are generally secured by tangible assets and often supplied by the captive finance companies of manufacturers of automobiles and other equipment. In contrast, small businesses rarely obtain unsecured loans or lines of credit from nondepository institutions. Slightly fewer than ten percent had loans from family and friends.

The survey indicates that the use of nonbank sources increases with firm size. In particular, very small firms rarely used nondepository sources, whereas about forty percent of firms with fifty or more employees used nondepository sources.

Overall, the survey confirms that banks, especially local institutions, continue to play a major role in small business finance. The relationship between banks and small businesses involves a wide range of services supplied by the bank.

Looking Ahead: Banks and Small Business Lending

Looking ahead, there are a number of developments in banking markets that may be significant for small business borrowers. Perhaps the most prominent is the ongoing consolidation of the banking industry. Some fear that this trend may impede the flow of credit to small businesses and disrupt the relationships that many small businesses have with their local banks. This issue deserves careful attention, and I think it worthwhile to offer a few thoughts on the subject this morning.

First, it is important that we put the trend in merger activity in perspective. In the past ten years, the U.S. banking structure has undergone extensive change as banks have adjusted to the removal of longstanding restrictions on interstate banking and have responded to technological change and growing international competition. One result has been a sharp decline in the number of banking institutions--from more than 14,000 in 1985 to near 10,000 in 1995. Part of this decline was a result of bank failures: nearly 1,200 banks were forced to close and many weak institutions were merged.

Despite the decline in the number of banks, the number of banking offices and branches has risen sharply. (Banking offices jumped from 53,000 in 1980 to 65,000 in 1995.) There appears to have been no reduction in the availability of banking offices serving the public.

Moreover, analyses of banking markets over the years have provided little support for the notion that when large banks enter a market, they drive out the smaller banks. Rather, small banks have been and continue to be able to retain market shares and operate profitably in competition with larger banks. Our staff studies have shown that smaller banks typically perform as well or better than their larger counterpart, even in markets dominated by large institutions.

This makes it hard to accept the notion that profitable lending opportunities in our local communities will be unmet. If the local bank is making profitable small business loans, it seems logical that its acquirer would continue to make those loans. Should large banks find it is too costly to establish a lending presence in small business markets--perhaps because it is inefficient for large, remote

institutions to maintain close working relationships with small customers--then other small banks in the area will be positioned to fill the gap. Consistent with this view, there were reports that community banks were eagerly looking to increase their market shares following some of the larger bank mergers last year.

Although some banking relationships inevitably will be disturbed when ownership and management change, we would expect these effects to be short-lived.

I offer these generalizations with caution. The Federal Reserve takes very seriously its responsibility for evaluating the possible impact of bank mergers on local markets. We have found that each assessment must be done on a case-by-case and market-by-market basis. To this end, we devote considerable resources to assessing competitive impacts, CRA concerns, and a variety of other factors. We will be watching closely for evidence that small businesses are being disadvantaged by bank mergers.

Other Developments

A number of other changes in the credit markets seemingly bode well for small business financing, including the efforts of large institutions to meet community development concerns and enhance their presence in local markets. Recently, large West Coast banks have announced programs that would channel billions of dollars into small business lending. Some of these programs reportedly have been structured to streamline the application process and make it easier for small businesses to obtain loan approval on a timely basis.

In addition, new technologies and information flows are providing opportunities for banks and other lenders to more efficiently evaluate loan risks. One technique that is rapidly gaining acceptance is credit scoring. Credit scoring is a statistical procedure that provides an estimate of default probability for individual loans, based on borrower and loan characteristics. The development of credit scoring models requires that lenders have access to a large amount of historical information on the performance of loans with similar characteristics. It inevitably will take time to develop data bases of small business loans, given the diverse characteristics of the millions of small borrowers. But, once developed, credit scoring and loan standardization may offer significant cost advantages for evaluating the risks associated with lending. Many large banks already have begun to probe the possibilities of credit scoring techniques for small business markets.

As credit scoring and loan standardization become more commonplace, we may well see growth in the amount of small business loan securitization. To date that growth has been hampered by the huge diversity among small business borrowers and the difficulty in accurately assessing the riskiness of pools of nonstandard small business loans. In contrast, the bulk of loans that are backed by the Small Business Administration (SBA) have been more easily securitized because they are known to be low risk by virtue of their guarantee. The ability to securitize non-SBA loans would increase the liquidity of small business lending and provide banks and other lenders with additional sources of funding. We anticipate that the cost savings generated through these new processes will be passed on, at least in part, to small business customers.

Clearly not all small business loans are going to be appropriate candidates for securitization, and not all banks will wish to adopt complex statistical models for managing risks. There will continue to be a market for nonstandard small business lending and a role for regional and community banks. Of course, we should also expect that small businesses that do not easily fit the standard models will not share in the cost savings that credit scoring will provide.

The agencies also have worked to improve the liquidity of small business loans by refining the risk-based capital standards for those loans sold with recourse. In response to section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994, the agencies lowered the capital requirement for small business loans that are transferred with recourse by well capitalized banking organizations. This change should facilitate the securitization of small business loans, while at the same time ensuring that qualifying banks hold adequate capital.

The banking agencies are mindful of the fact that loans to small businesses are vulnerable to regulatory burden as well. Spreading fixed regulatory compliance costs over small balances can make such loans more costly to originate than large loans. Thus, the agencies took great care to avoid unnecessary costs when we implemented safety and soundness standards pursuant to section 132 of FDICIA. That law directed the agencies to provide safety and soundness standards for, among other things, loan documentation and credit underwriting. Rather than prescribing detailed and costly requirements on what should be contained in a file for a small business loan, the standards establish goals for the documentation, leaving the

specific methods for achieving those goals to each institution.

Summary

Let me conclude by saying that I am optimistic about the outlook for small business credit availability. We have emerged from the credit crunch into a much sounder financing environment and a well-balanced economic expansion. Bank balance sheets are vastly improved. Moreover, many of the new developments in banking point to more efficient risk management techniques that could lower costs of small business lending. At the same time, many of our large banks have become quite actively involved in small business and community development programs.

Our conversations with bankers and small business groups suggest that bank regulatory issues are not the pressing concern today that they were a few years earlier. Nonetheless, we as regulators will continue to review our rules and procedures to ensure that unnecessary burdens do not hinder banks' willingness to lend to creditworthy small businesses.

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